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Managing Editor

The NEW YORK CERTIFIED PUBLIC ACCOUNTANT *is published monthly. Copies may be obtained at the office of the Society at twenty-five cents per copy, $3.00 per year.*

Message from the President

To the Members

Our aim as individuals and as a Society is to give all possible aid to our country in the winning of the war. As we enter 1943, the results of last year's efforts by the American people are already manifest. But it is not yet the occasion for satisfaction over what has been accomplished. It is rather the time when we must apply new energy and intensify our efforts, in support of our armed forces and our government in every measure which in their opinion will bring victory nearer.

Each member of the Society must determine the means by which he can make the greatest contribution in this common purpose. I know that all will continue to give unstintingly of their time and abilities. We can find faith and satisfaction in the knowledge that we can never serve a cause more noble.

J. ARTHUR MARVIN,
President.

STATE SOCIETY ACTIVITIES

Calendar of Events

January 7—Regular Meeting of the Board of Directors.

January 11—7:30 P.M. Society Meeting. Subject: **The Revenue Act of 1942.** Location: Waldorf-Astoria Hotel, Lexington Avenue and 49th Street, New York City.

February 18—Regular Meeting of the Board of Directors.

March 18—Regular Meeting of the Board of Directors.

March 22—7:30 P.M. Society Meeting. Subject: To be announced. Location: Waldorf-Astoria Hotel, Lexington Avenue and 49th Street, New York City.

January Society Meeting

On the evening of January 11, 1943, the Society had the pleasure of hearing a paper by J. K. Lasser, member of the Committee on Federal Taxation, on the subject of "Corporate Taxes under the 1942 Law." This was followed by the presentation of an address by Paul D. Seghers, vice chairman of the Committee on Federal Taxation, on "Relief Provisions under the Excess Profits Tax." A question and answer period followed.

No February Meeting

As provided in the By-Laws of the Society, the Board of Directors has again dispensed with the February Society meeting because of the fact that members will be under extra heavy pressure during that month.

The next regular meeting of the Society is scheduled for March 22, 1943.

Amendment to the By-Laws

At the December 19, 1942 Society meeting, the Committee on Amendments to the By-Laws presented its report on proposed amendment to Article V, Paragraphs 7 and 8 of the By-Laws which was read at the meetings of the Society on October 5th and November 9th. A motion to adopt the amendment was unanimously carried so that the revised Article V, Paragraphs 7 and 8 reads as follows:

"Paragraph 7 — Seven members shall constitute a quorum of the board of directors.

"Paragraph 8—A majority vote of the members present at any meeting of the board shall be necessary on any question brought before it except that when less than eleven members are present six votes for any motion shall be required and except in respect to the suspension or expulsion of a member or associate member by vote of the board, in which instance a majority vote of the entire board shall be necessary, provided that when suspension or termination of membership is automatic, as elsewhere provided in these by-laws, vote of the board shall not be necessary."

Wartime Problems Release No. 20

The Committee on Wartime Problems on December 29, 1942, sent to the membership Release No. 20, which was entitled "Post-War Refund of Excess-Profits Tax." This consisted of a reprint of the American Institute of Accountants' Ac-

counting Research Bulletin No. 17. The bulletin deals with the reporting, in financial statements, of the post-war refund of excess-profits tax provided for in section 250 of the Revenue Act of 1942.

1942 Year Book

Due to the unprecedented number of address changes, the publication of the 1942 Year Book of the Society has been delayed. This has now gone to press, and it is expected that it will be in the members' hands the latter part of January.

Fred Tourin

Fred Tourin, a member of the Society since 1928, died suddenly on December 24, 1942, at the age of 52. He was a partner of Shmerler & Tourin, and is survived by his wife and three children.

The Society has suffered a real loss in his passing.

ANNOUNCEMENT OF

PRIZE ESSAY CONTEST

The Board of Directors of the Society has authorized the Committee on Publications to conduct a prize essay contest, the essays to be on a subject of interest to the accounting profession and suitable for publication in THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT. Prizes in the amount of $150 for first prize, $100 for second prize, and $50 for third prize are offered.

The general rules of the contest are as follows:

All manuscripts shall be typed in duplicate on 8½ x 11 stationery, double or triple space typing, and should not be more than 5000 words.

★

The name of the individual submitting the paper shall not appear on same, nor should there be any other means of identifying the manuscripts, which should be accompanied by a covering letter giving the contestant's name and address and firm connection.

★

When submitted to the judges, each manuscript will be given a key number of identification.

★

Manuscripts should be forwarded to The Managing Editor of the New York Certified Public Accountant, 15 East 41st Street, New York City, on or before June 1, 1943. Awards will be announced as soon thereafter as possible.

★

All papers submitted shall become the property of the New York State Society of Certified Public Accountants and shall be available for publication in the New York Certified Public Accountant. The decision of the judges shall be final as to what papers may be entitled to prizes.

PROFESSIONAL COMMENT

Effect of Salary and Wage Increases on Ceiling Prices

Rules under which employers can ask for price adjustments on salary or wage increases requiring approval of the National War Labor Board were established by the Office of Price Administration.

The OPA issued a statement for employers seeking the price adjustment, which emphasized that, with present adjustment policy, the price increases will be granted only when they are essential to prosecution of the war, or "to a standard of living consistent with prosecution of the war."

The new procedure, effective immediately, covers the following principal points:

(1) The request for price adjustment must be made before the proposed salary or wage increases go into effect or OPA will not, at a later date, grant price increases based on these grounds alone. (However, the fact that the employer failed to file such a request with OPA will not preclude recognition of the increased labor cost resulting from the salary or wage increases in considering any later application for adjustment or petition for amendment based on later changes in circumstances.)

(2) The employer should file request for price adjustment with OPA within fifteen days after the salary or wage increase application is made to the WLB. In case of a disputed proceeding before the board, the employer request should be filed with OPA within fifteen days after the employer receives notice that the WLB has taken jurisdiction over the case.

(3) The new procedure cuts across all price regulations and supplements those which already contain price adjustment procedures.

1942 Tax Forms

Printing of 180,000,000 forms for individual income tax returns on 1942 incomes has been substantially completed and distribution of the forms to offices of the nation's sixty-four Internal Revenue collection districts is well under way, it was announced on January 2, 1943, by Commissioner Guy T. Helvering of the Bureau of Internal Revenue.

Where wartime difficulties of paper supply and transportation have delayed either production or shipment of the forms, every effort is being made to finish supplying the collection offices within the near future, Mr. Helvering said. Collectors in turn are hastening the distribution of forms to the public, by mailing copies to all income tax payers of record and by supplying the forms in quantities to post offices, banks, public offices and employers generally.

SECURITIES AND EXCHANGE COMMISSION RELEASES

Accounting Series Release No. 38, December 19, 1942

The Securities and Exchange Commission today made public an opinion of its Chief Accountant in its Accounting Series relative to the manner in which post-war refunds of Federal excess profits taxes should be treated in financial statements.

The opinion, prepared by William W. Werntz, Chief Accountant, in response to an inquiry, follows:

"You have inquired with respect to the

propriety of the manner in which the company proposes to reflect in its financial statements the post-war refunds of Federal excess profits taxes which are provided for by Section 250 of the Revenue Act of 1942.[1] You state that the corporation's tax return will indicate that the corporation will be subject to an excess profits tax of $1,000,000, that the company will therefore be entitled under the statute to a post-war refund credit amounting to $100,000, and that within three months after the payment of the tax the company will be entitled to receive bonds of the United States in an aggregate face amount equal to the credit so established. You note that the Act provides that such bonds shall bear no interest, and only after, and not before, cessation of hostilities in the present war may the bonds be transferred by sale, exchange, assignment, pledge hypothecation, or otherwise.

"As I understand it, you propose to deduct in your profit and loss statement excess profits taxes in the amount of $900,000, the net amount of such taxes ultimately payable. However, disclosure will be made of the gross amount of the tax and of the net credit there against. Concurrently, you propose to set up an asset account in the amount of $100,000 to reflect the amount receivable as a post-war refund and to reflect $1,000,000 as a current liability. When bonds are received the caption of the account will be altered to indicate that fact. You thus propose to treat the total amount payable as, in effect, partially a payment of taxes and partially, to the extent of the post-war credit, as an investment in a special type of government bonds.

"Upon the basis of the facts stated, the treatment you propose is, in my opinion, in accordance with sound and generally accepted accounting principles and practice and should be followed. However, in view of its special characteristics, the amount receivable as a post--war refund should not, in my opinion, be presently classified as current assets or investments, but should rather be shown among 'other assets.' "

[1] New Part III, comprising Sections 780-783, Subchapter E of Chapter 2, Internal Revenue Code.

Accounting Series Release No. 39, December 19, 1942

The Securities and Exchange Commission today announced the adoption of certain revisions, effective January 1, 1943, to its Uniform System of Accounts for Public Utility Holding Companies. Since printed copies of the system of accounts as revised will not be available for distribution for some time, the amendments in mimeographed form are attached to this release. Under the provisions of Rule U-26 the revised system, subject to certain exceptions, is applicable to all registered public utility holding companies and their subsidiary holding companies. The principal exception covers holding companies which are also operating companies.

The original system of accounts prescribed for public utility holding companies was adopted August 8, 1936, became effective January 1, 1937, and has continued in effect without change up to the present revisions. Experience with the system over the past six years, however, indicated that certain changes might profitably be made. Accordingly, amendments proposed by the staff and others were transmitted for consideration and comment to representatives of the utility industry, professional accounting societies, State and Federal regulatory bodies, and others. After careful consideration of the replies received the proposed amendments have been revised and adopted by the Commission. In addition to certain technical changes and other minor changes designed to improve and clarify the system of accounts, revisions of a substantive character were made in the following accounts:

The revised text of Account 100, Investment Securities and Adances, includes a new paragraph relating to investments now carried at unsegregated book amounts. Where it is not possible to determine from the accounts and supporting records the amount applicable to each of such investments, it is provided that they may be stated at one amount but, hereafter, upon sale or disposal of any such investment, the unsegregated amount is required to be allocated to each investment unless the Commission otherwise approves or directs, the method of allocation being subject to the approval or direction of the Commission.

The revised texts of Account 120, Discount on Capital Stock; Account 121, Commissions and Expense on Capital Stock; Account 130, Reacquired Capital Stock; and Account 150, Capital Stock, now provide that premiums and assessments on one class of capital stock may not gen-

erally, without approval of the Commission, be used to absorb discount and repurchase premium on capital stock of a different class.

The text of Account 200, Dividends, in the original system has been substantially changed by notes A and B in the revised system. Note A now prohibits the taking up of stock dividends as income or surplus if the stock received as a dividend is of the same class as the stock on which the dividend in stock is paid. Under the original system stock dividends might be taken into income or surplus under certain conditions if the recipient company chose to do so. A new note B provides that if the dividend received in stock is of a class different from that on which the dividend is paid, the dividend may, with prior approval of the Commission, be treated as income.

Account 240, Taxes, other than Income Taxes, and Account 270, Income Taxes, in the revised system supersede Account 240, Taxes, in the original system and result in separating income taxes from other taxes. The order of presentation of the accounts also indicates that income taxes should be shown as the last item of deductions in computing net income rather than as an operating expense.

While the revision of the Classification was in process, a suggestion was received that holding company investments be carried at amounts which reflect their equity in the subsidiaries on the basis of the underlying original cost of the subsidiaries' property, less appropriate depreciation and depletion reserves, and that any present excess over that amount be segregated and eventually eliminated. While this proposal was rejected, it was recognized that in balance sheets of public utility companies, it is important to set forth tangible and intangible utility plant so as to show separately the original cost, plant acquisition adjustments, and plant adjustments, and, in consolidated balance sheets of a public utility holding company and its subsidiaries, to show in addition the difference between the parent's investment in and the underlying book equity of subsidiaries as at the respective dates of acquisition. It is therefore proposed to adopt rules to require such segregation in financial statements filed with the Commission where original cost studies have been completed and to require appropriate footnote disclosures where such original cost studies are not completed or required.

The text of the Commission's action follows:

Acting pursuant to the authority granted by the Public Utility Holding Company Act of 1935, particularly Sections 15 and 20 (a) thereof, and finding such action necessary and appropriate in the public interest and for the protection of investors and consumers, and to carry out the provisions of said Act, the Securities and Exchange Commission hereby amends the Uniform System of Accounts for Public Utility Holding Companies, Dated August 8, 1936, effective January 1. 1937. This system of accounts, as revised, in the form annexed hereto, is for use, effective January 1, 1943, as prescribed in Rule U-26 of the General Rules and Regulations of the Commission under said Act.

The system of accounts, as revised, will not be available in final printed form until sometime early in 1943. Until such time, however, there are attached, for use by registered holding companies and others, the paragraphs of the system of accounts, as revised, which have been changed. Paragraphs revised for minor or clarifying changes in language are not necessarily given.

Amendments to Uniform System of Accounts for Public Utility Holding Companies

(The following sections or paragraphs give effect to the amendments adopted)

GENERAL INSTRUCTIONS

1. Companies for Which This System of Accounts is Prescribed.

   This system of accounts is prescribed for holding companies subject to the provisions of Rule U-26 adopted under the Public Utiltiy Holding Company Act of 1935. Attention is directed to Sections 15 (e) and 20 (b) of the Act and Rule U-26 which, except as otherwise specifically provided therein, make it unlawful for any company subject to the provisions of this system of accounts to keep any accounts in lieu of those herein provided, or to keep the accounts herein provided in a manner other than as prescribed or approved by the Commission.

2. Submission of Questions.

   To promote and maintain uniformity and sound accounting there shall be submitted to the Commission for consideration and decision all cases in which the Company is uncertain as to the interpretation of the prescribed accounting rules or the accounting procedure to be followed.

3. Records.

   C. No company shall destroy any books or records as defined in paragraph (B) above without first having obtained the consent and approval of the Commission.

4. Definitions—When Used in This System of Accounts.

B. "Actually outstanding," as applied to certificates of capital stock or evidences of debt, means those which have been issued (or assumed) by the company and neither have been retired, nor have been reacquired by or for the company, nor are held in its sinking or other funds.

E. "Book amount" means the amount at which assets are recorded in the accounts of the company (without deduction of any related reserves or other items).

(Note: As a result of this change, the term "book cost" will be changed to read "book amount" wherever used in the revised system.)

8. Basis of Recording Investments on Books.

B. If the consideration given for any investment is other than cash or securities issued by the acquiring company, the cost of the investment acquired shall, except as provided under instruction 9, "Investments acquired in reorganization," be deemed to be the fair current value of the consideration given. If the consideration given for any investment consists of securities issued by the acquiring company, the cost of the investment acquired shall be deemed to be the fair current value of such investment.

9. Investments Acquired in Reorganization.

C. It is the intention that the reserve, so far as it is adequate, shall be used to adjust all differences between the amount originally set up on the books with respect to the items to which the reserve relates and fair current values as finally determined; and that the reserve shall be affected only by losses or gains clearly attributable to operations or events originating prior to date of acquisition and inherent in the investment at date of acquisition.

E. This paragraph is stricken.

Balance-Sheet Accounts

Asset and Other Debit Accounts

100. Investment Securities and Advances.

This account shall include the book amount of investments in other companies, except such as may be includible in account 101, "Miscellaneous investments." Include in this account the book amount of investments in common stocks, preferred stocks, bonds, notes, and other obligations, issued or assumed by other companies, and also the amount of advances to them on open account not subject to current settlement.

Records shall be maintained in such manner that the company can report separately the amount of investments in, and advances to, (a) subsidiaries, majority owned, which are (1) consolidated, (2) not consolidated in the consolidated balance sheet of the company; (b) investments in other statutory subsidiaries; (c) investments in other associate companies; and (d) investments in other companies. (Note general instructions 4D and 4L).

Records supporting the entries to this account shall be kept to show the book amount of each of the following kinds of investment in each company:

(a) Common stocks (by classes).
(b) Preferred stocks (by classes).
(c) Bonds (by classes).
(d) Other secured obligations (specified).
(e) Unsecured notes.
(f) Advances on open account.

If two or more investments acquired prior to the effective date of this system of accounts are carried at an unsegregated book amount and it is not possible to determine from the accounts and supporting records the portions thereof applicable to each, they may be stated in one amount, provided that upon the sale or other disposal of any of such investments the unsegregated amount shall be allocated to each investment unless the Commission otherwise approves or directs. The method followed in making the allocation shall be such as the Commission may approve or direct.

105. Organization.

Note B.—Amounts included in this account on the books of companies merged, consolidated or reorganized shall not be carried forward to this account on the books of the successor or continuing corporation except to the extent approved by the Commission.

112. Temporary Cash Investments.

Note A.—Securities issued or assumed by the company or any associate company shall not be included in this account.

116. Dividends Receivable.

This account shall include the amount of dividends receivable on stocks owned, but unpaid at the date of the balance sheet. Dividends shall not be taken up before they are declared, nor unless payment is reasonably assured by past experience, guaranty, or otherwise.

120. Discount on Capital Stock.

Second paragraph—

Discount on a particular class and series of capital stock may be offset or

reduced by charges to capital surplus to the extent that premiums and assessments on the particular class and series of capital stock, and net gain from reacquisition and resale of any class or series of stock, are included therein. Discount on one class or series of capital stock may not be offset or reduced by charges to capital surplus arising from premium and assessments on any other class or series of capital stock without the approval of the Commission.

Third paragraph—

Discount on capital stock may be charged to capital surplus to the extent indicated in the preceding paragraph, or it may be written off to earned surplus.

Add to Note—

The provisions of this account shall not be construed as indicating approval by the Commission of the issuance of stock at a discount.

121. Commissions and Expense on Capital Stock.

First paragraph—

This account shall include commissions and expense incurred in connection with the issuance and sale of capital stock. Records supporting the entries to this account shall be kept to show commissions and expense on each class and series of capital stock. The expense chargeable to this account shall include all such expenses not includible in account 105, "Organization."

Second paragraph—

This paragraph is stricken.

Third paragraph—

Commissions and expense relating to capital stock may be written off to earned surplus or amortized by charges to income. Credits made to this account for amortization shall be concurrently charged to account 255, "Miscellaneous amortization charges to income."

Fourth paragraph—

When an issue of capital stock, or any part thereof, is reacquired there shall be credited to this account the amount of commissions and expense on original sale, if any, applicable to such stock reacquired and concurrent charge made to income or earned surplus.

126. Unamortized Debt Discount and Expense.

Third paragraph—

Discount and expense incurred in connection with the issue and sale of funded debt shall be amortized by the consistent application of a rule by which the entire amount of discount and expense pertaining to any issue shall be amortized through such regular charges to income as will equitably distribute the balance thereof during the life of such issue.

Fourth paragraph—

When an issue of funded debt, or any part thereof, is retired prior to maturity and not in connection with a refunding operation, any remaining balance of unamortized discount and expense pertaining thereto shall be charged to earned surplus, except as the Commission shall otherwise approve or direct.

Fifth paragraph—

When an issue of funded debt, or any part thereof, is refunded and at the date of refunding there is a balance of unamortized discount and expense relating thereto, the amount of such balance together with any premium paid in retiring the debt shall be disposed of in such manner as the Commission may approve or direct.

130. Reacquired Capital Stock.

Third paragraph—

When reacquired capital stock is sold, the difference between the amount at which such stock is included in this account and the net sale price realized shall be credited or debited, as appropriate, to account 190, "Capital surplus," subject to the restriction described in the preceding paragraph.

131. Reaquired Funded Debt.

Second paragraph—

The difference between the face amount of bonds or other funded debt included in this account and the amount paid by the company for such securities, including commissions and expenses paid in connection with the reacquisition, shall be credited or debited as appropriate to account 305, "Other credits to earned surplus" or account 315, "Other debits to earned surplus" except as the Commission shall otherwise approve or direct. Concurrently the portion of unamortized premium, discount, and expense relating to the funded debt reacquired shall be credited or debited as appropriate to account 305, "Other credits to earned surplus," or account 315, "Other debits to earned surplus," except as the Commission shall otherwise approve or direct.

Liability and Other Credit Accounts

150. Capital Stock.

New fourth paragraph—

Premium paid upon the redemption and retirement of capital stock shall be charged to earned surplus, provided,

however, that such premium may be charged to capital surplus to the extent that premium on original issuance of such stock retired and gains from reacquisition and resale of the same or any other class or series of capital stock are included in capital surplus, or may be disposed of in such other manner as the Commission may approve or direct.

170. Premium on Funded Debt.

Fourth paragraph—

When an issue of funded debt, or any part thereof, is retired prior to maturity and not in connection with a refunding operation any remaining balance of premium pertaining thereto shall be credited to earned surplus, except as the Commission shall otherwise approve or direct.

Last paragraph—

When an issue of funded debt, or any part thereof, is refunded and at the date of refunding there is a balance of unamortized premium relating thereto, the amount of such balance shall be disposed of in such manner as the Commission may approve or direct.

190. Capital Surplus.

First paragraph—

This account shall include all surplus arising from sources other than those classifiable under earned surplus accounts. (Note general instruction 14.) Records supporting the entries to this account shall be kept in such manner as to disclose the nature and source thereof, and as to enable the company to furnish full particulars concerning any item.

Income Accounts

200. Dividends.

Note A.—A dividend received in stock of a paying company of the same class as the stock on which such dividend is paid shall not be treated as income. No amount shall be charged to investments or credited to income or surplus from any such dividend stock at any value at the time such dividend is received. Proceeds realized from subsequent sale or disposal of the stock so received as a dividend or of the stock in respect of which the dividend was paid, shall be accounted for as appropriate, proper credit being given in the investment account for the proportion of the book amount applicable to the shares sold or disposed of. Any profit or loss resulting from the transaction shall be credited or debited to accounts 204, 301, or 311, as appropriate.

Note B.—A dividend received in stock of a paying company of a class other than that on which such dividend is paid may with prior approval of the Commission be treated as income. If not treated as income, the book amount at which the company carries the stock on which such dividend is declared shall be appropriately allocated between the stock previously held and the stock received as a dividend. Such allocation shall be subject to the approval of the Commission.

Notes B, C, and D become Notes C, D, and E, respectively.

240. Taxes, Other Than Income Taxes.

This account shall include provision for all taxes, applicable to the period for which the income account is stated, except income and excess profits taxes which shall be charged to account 270, "Income taxes." Taxes accrued through this account prior to their payment shall be credited to account 166, "Accrued taxes."

This account shall be kept in such manner as to show the amount of each class of taxes.

250. Interest on Funded Debt.

This account shall include the amount of interest applicable to the period for which the income account is stated on all classes and series of funded debt actually outstanding. Interest accrued through this account prior to the payment thereof shall be credited to account 163, "Accrued interest on funded debt."

270. Income Taxes. (new account)

This account shall include provision for Federal income and excess profits taxes; and for other income taxes, applicable to the period for which the income account is stated. Taxes accrued through this account prior to their payment shall be credited to account 166, "Accrued taxes."

This account shall be kept in such manner as to show the amount of each class of taxes.

(Accounts 260 and 261 have been renumbered 280 and 281, respectively.)

Earned Surplus Accounts

311. Profit From Sale of Investments.

First paragraph—

This account shall include losses sustained from the sale or disposal of investments included in investment, sinking fund, or other special fund accounts, to the extent that such losses exceed the amount of reserves provided therefor.

312. Investments Written Down or Written Off.

First paragraph—

This account shall include such amounts as may be credited to investment, sinking fund, or other special fund accounts to write down or write off the book amount of specific investments included therein to the extent that such amounts have not been provided for in reserves.

Second paragraph—

Amounts charged to this account as well as amounts charged for the same purpose to reserves shall be credited directly to the appropriate investment or other account in which is included the book amount of the investment to which the charges relate. Charges and credits as contemplated by this account shall not be made unless they represent a definitely recognized loss. The account shall not be used to record fluctuations in the market value of securities owned; charges made to provide a reserve for this purpose shall be included in account 313, "Surplus appropriated to reserves."

Accounting Series Release No. 40, December 22, 1942

The Securities and Exchange Commission today announced the adoption of amendments to Rules 3-01, 3-02, 5-02, 5-04, 12-06, 12-08, and 12-14 of Regulation S-X. The changes made are part of a comprehensive revision of the reporting requirements designed to facilitate the furnishing of information with a minimum burden and expense.

The amendment to Rule 3-01 permits the statement in thousands of dollars of all amounts appearing in financial statements, thereby substantially reducing the size of the statements and the time required for their preparation in final form. The amendment to Rule 5-02 provides that no classification of inventories in contravention of the Code of Wartime Practices shall be required in the financial statements of companies engaged in the war effort. The amendments to Rules 3-02, 5-04, 12-06, 12-08, and 12-14 are designed to simplify and shorten the reports required to be filed by registrants by permitting under designated conditions the omission or partial omission of certain schedules.

The text of the Commission's action follows:

The Securities and Exchange Commission, acting pursuant to authority conferred upon it by the Securities Act of 1933, particularly Sections 7 and 19 (a) thereof, the Securities Exchange Act of 1934, particularly Sections 12, 13, 15 (d), and 23 (a) thereof, and the Investment Company Act of 1940, particularly Sections 8, 30, and 38 (a) thereof, and deeming such action necessary and appropriate in the public interest and for the protection of investors and necessary for the execution of the functions vested in it by the said Acts, hereby amends Regulation S-X as follows:

1. Rule 3-01 is amended as follows:

The letter (a) is inserted preceding the text of the existing rule and the following paragraph is added thereto:

(b) All money amounts required to be shown in financial statements and schedules may be expressed in thousands of dollars, provided that an indication to that effect is inserted immediately beneath the caption of the statement or schedule, or at the top of each money column. Zeros need not be inserted for the omitted figures. The individual amounts shown need not be adjusted to the nearest thousand if in a footnote it is stated that the failure of the items to add to the totals shown is due to the dropping of amounts less than one thousand dollars.

II. Rule 3-02 is amended by deleting the third sentence thereof.

III. Caption 6 of Rule 5-02 is amended by adding a new subparagraph (c) as follows:

(c) Notwithstanding the provisions of paragraphs (a) and (b) of this rule, no classification of inventories shall be required which is in contravention of the Code of Wartime Practices.

IV. Rule 5-04 is amended:

A. By deleting the period at the end of the first sentence of paragraph (a) (1) thereof and inserting the following:

, provided that any such schedule (other than Schedule I) may be omitted if all the following conditions exist:

(a) The financial statements are being filed as part of an annual or other periodic report;

(b) The information that would be shown in the respective columns of such schedule would reflect no changes as to any issue of securities of the registrant or any significant subsidiary in excess of 5% of the outstanding securities of such issue as shown in the most

recently filed annual report containing such schedule; and

(c) Any information required by columns G and H of Schedule XIII—Capital shares, is shown in the related balance sheet or in a footnote thereto.

B. By adding the following new subparagraph (d):

(d) If the information required by any schedule (including the footnotes thereto) may be shown in the related balance sheet without making such statement unclear or confusing, that procedure may be followed and the schedule omitted.

V. Paragraph (a) (2) of Rule 5-04 is amended by deleting the third sentence thereof.

VI. The text of Rule 5-04 following the caption, Schedule III—Investments in securities of affiliates, is amended by deleting the period at the end thereof and adding the following:

, provided that this schedule may be omitted if (1) neither the sum of captions 9 and 10 in the related balance sheet nor the amount of caption 29 in such balance sheet exceeds 5% of total assets (exclusive of intangible assets) as shown by the related balance sheet at either the beginning or end of the period or (2) there have been no changes in the information required to be filed from that last previously reported.

VII. The text of Rule 5-04 following the caption, Schedule IV—Indebtedness of affiliates—Not current, is amended by adding the following sentence at the end thereof:

This schedule may be omitted if (1) neither the sum of captions 9 and 10 in the related balance sheet nor the amount of caption 29 in such balance sheet exceeds 5% of total assets (exclusive of intangible assets) as shown by the related balance sheet at either the beginning or end of the period, or (2) there have been no changes in the information required to be filed from that last previously reported.

VIII. The text of Rule 5-04 following the caption, Schedule V—Property, plant, and equipment, is amended by deleting the period at the end thereof and adding the following:

, provided that this schedule may be omitted if the total shown by caption 13 is less than 10% of total assets exclusive of intangible assets as shown by the related balance sheet at both the beginning and end of the period and if neither the additions nor deductions during the period exceeded 10% of total assets (exclusive of intangible assets) as shown by the related balance sheet.

IX. The text of Rule 5-04 following the caption, Schedule VI—Reserves for depreciation, depletion, and amortization of property, plant, and equipment, is amended by adding the following sentence at the end thereof:

This schedule may be omitted if Schedule V is omitted.

X. The text of Rule 5-04 following the caption, Schedule X—Indebtedness to affiliates—Not current, is amended by inserting the following at the end thereof:

This schedule may be omitted if (1) neither the sum of captions 9 and 10 in the related balance sheet nor the amount of caption 29 in such balance sheet exceeds 5% of total assets (exclusive of intangible assets) as shown by the related balance sheet at either the beginning or end of the period, or (2) there have been no changes in the information required to be filed from that last previously reported.

XI. The text of Rule 5-04 following the caption, Schedule XVI—Supplementary profit and loss information, is amended by adding the following sentence:

This schedule may also be omitted if the information required by columns B and C and footnotes 4 and 5 thereof is furnished in the profit and loss or income statement or in a footnote thereto.

XII. The text of Rule 5-04 following the caption, Schedule XVII—Income from dividends—Equity in Net Profit and Loss of Affiliates, is amended by adding the following statement:

This schedule may be omitted if neither the sum of captions 9 and 10 in the related balance sheet nor the amount of caption 29 in such balance sheet exceeds 5% of total assets (exclusive of intangible assets) as shown by the related balance sheet at either the beginning or end of the period.

XIII. Rule 12-06—Property, Plant, and Equipment, is amended by adding the following sentence to note 3:

If neither the total additions nor the total reductions during the period amount to more than 10% of the closing balance and a statement to that effect is made, Columns B, C, D, and E may be omitted. In such case any information required by notes 4, 5, and 6 shall, however, be given and may be in summarized form.

XIV. Rule 12-08, Intangible Assets, is amended by adding the following sentence to note 3:

If neither the total additions nor the total reductions during the period amount to more than 10% of the closing balance and a statement to that effect

is made, Columns B, C, D, and E may be omitted by any company other than a public utility company. Any information required by note 4 or 5 shall, however, be given and may be in summarized form.

XV. Rule 12-14, Capital Shares, is amended by deleting the period at the end of the first sentence of footnote 2 thereof, and inserting the following:

, *provided* that when this schedule is filed in support of a consolidated statement, the information required by Columns A—H inclusive need not be given as to any consolidated subsidiary if all of the outstanding shares of each issue of capital shares (other than directors' qualifying shares) of such subsidiary are held by one or more of the persons included in such consolidated statement; if the answer to Columns G and H would be none; and if a footnote indicating such omission is given.

Effective December 22, 1942.

Accounting Series Release No. 41, December 22, 1942

The Securities and Exchange Commission today issued an opinion in its Accounting Series dealing with certain accounting aspects of the recent amendments to Forms 10-K and N-30A-1, the principal annual reporting forms under Section 13 of the Securities Exchange Act. These amendments, which were adopted in connection with recent revisions of the rules governing proxy solicitations, permit companies to file copies of their regular annual reports to stockholders in place of certain of the financial statements required to be filed by such forms, if the financial statements included in the annual report to stockholders substantially conform to the requirements of Regulation S-X, the underlying accounting regulation of the Commission. The opinion, prepared by William W. Werntz, Chief Accountant, indicates that while the financial statements included in reports to stockholders are frequently somewhat more condensed than those filed in accordance with the requirements of those forms and Regulation S-X, such condensation, if limited to the grouping of items that are not substantial in amount or otherwise material because of their particular origin or nature, would not prevent the filing of such financial statements in place of those required by the instructions.

The full text of the opinion follows:

"A recent amendment of Form 10-K provides that in partial response to the requirements for filing financial statements a registrant may if it wishes file a copy of its regular annual report to stockholders and incorporate by reference the financial statements contained in such report. This procedure may be followed, however, only if the financial statements included in the report to stockholders substantially conform to the requirements of Regulation S-X. Of course, any financial statements or schedules required by the instructions that are not included in the stockholders' report must also be furnished.

"A review of numerous stockholders' reports covering the year 1941 indicates that in many cases the financial statements included are identical with those filed subsequently as part of the annual report on Form 10-K except that a number of relatively minor items shown separately in the report on Form 10-K are grouped, or combined with closely similar items in the report to stockholders. Inquiries have been received as to whether, where condensation of this type exists, the statements may nevertheless be considered to conform substantially to the requirements of Regulation S-X.

"The provisions of Article 5 of Regulation S-X contain a general statement of the details to be shown in balance sheets and income statements filed by commercial and industrial companies. Such requirements are, however, supplemented by and subject to the general rules contained in Article 3. Rule 3-06 thereof provides, on the one hand, that, in applying the requirements to the circumstances of an individual case, there shall be given, in addition to the required information, such further information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. On the other hand, Rule 3-02 provides that, if the amount to be shown under any particular caption is not significant, the caption need not be separately set forth. The effect of these two general requirements is to require the disclosure of significant information not specifically called for, but to permit the omission of information, even though covered by a specific requirement, if the item involved is not significant. It should be pointed out, however, that in some cases the significance of an item may be independent of the amount involved. For example, amounts due to and from officers and directors, because of their special nature and origin, ought generally to be set forth separately even though the dollar amounts involved are relatively

small. Likewise, disclosure of the various types of surplus, the important reserve accounts, and, under present conditions, the accrued liability for taxes is of importance. In the same way, in the corporate income statement of a company having large investments in subsidiaries or in the securities of unaffiliated companies, the disclosure of income from dividends and interest is necessary irrespective of the amount, since the absence or smallness of dividend and interest income is of as great importance as the exact amount thereof. In the income statement generally, it is important that the major elements such as sales and cost of sales, substantial items of other income and income deductions, and the provision for income and excess profits taxes be separately disclosed, unless to do so would violate the provisions of the Code of Wartime Practices. Finally, care should be taken that the necessary descriptive and explanatory footnotes applicable to the particular statements are set forth.

"On the other hand, the combination under a miscellaneous caption of minor items among the current assets or liabilities resulting from the ordinary course of business, or their combination with closely similar items that are large in amount, is, in my opinion, permissible and, where minor items are numerous, would tend to improve the legibility of the statements. Similar combinations appear to be permissible within the other major categories of items customarily appearing in the financial statements, such as deferred charges, prepaid expenses, and fixed assets. Generally, however, condensation in the balance sheet would not appear appropriate with respect to an item amounting to more than 10% of its immediate category, such as deferred charges, or more than 5% of total assets. Where, however, the immediate category is less than 5% of total assets, it would generally appear permissible to combine all components of the category under a suitable caption.

"If such condensation as may exist in the financial statements included in the regular annual report to stockholders has been made along the lines indicated, such financial statements would in my opinion substantially conform to the requirements of Regulation S-X and could therefore, under the recent amendment to Form 10-K, be incorporated by reference in annual reports on that form. Of course, care should be taken that the captions used are not such as to be misleading."

Form N-30A-1, the annual report form for investment companies subject to the Investment Company Act of 1940, has been amended in the same manner as Form 10-K. While the discussion above relates to the financial statements of commercial, industrial and utility companies using Form 10-K, comparable principles are applicable to investment companies using this form.

Renegotiation of Contracts—An Experience

By J. Arthur Marvin, C.P.A.

THE subject of general discussion before this gathering is the operation of Section 403 of Public Law 528, approved April 28, 1942, and the amendments made by Section 801 of Public Law 753, relating to the renegotiation of war contracts.

In order to handle this problem of renegotiating contracts, the United States Government has set up the Army, Navy, Treasury and Maritime Commission Price Adjustment Boards. It is natural that these boards should feel that the practices they have adopted result in a fair adjustment of any excess profits that may have been made by those engaged in production for war purposes. But how can you be sure that the general approach of these boards to this problem involves a desire to be fair to a contractor when the renegotiation actually occurs? In other words, are these boards making a judicial examination of each question, or is it their function to drive hard and ruthless bargains?

Obviously, the Boards represent the United States Government, and they must look after its interests. At the same time, they must consider the fact that industries engaged in the production of war materiel, or in furnishing a service essential to the war effort, must not be injured, or all of their work will go for nothing. Likewise, it is natural for anyone who has a problem before him which involves renegotiation of contracts to be somewhat anxious when approaching a discussion of this subject with the government authorities, as to just how much of their profit may have to be refunded. I think that this feeling on the part of the general public has come about through criticisms that were directed at the idea of renegotiation of contracts by people who had no conception of how this renegotiation was going to work out. These critics had but one thought and that was to discourage any proposition which might affect the profits of industries engaged in war production. I think, generally, all of you know, if you are maintaining proper cost records, when you are making profits on government contracts which appear to be excessive. I also think that those of you who produced war materiel during the first World War, or were closely associated with such production, appreciate that some very substantial profits were made which many of you considered excessive. In other instances, many concerns were hurt because of the post-war situation. Likewise, you are anxious to know that if you renegotiate your present contract, just what consideration the Price Adjustment Boards may give to the post-war problems you will face after the present global war is ended.

The original profit limitation plan introduced in Congress provided for the limitation of all war profits by establishing a fixed percentage to be added to the cost of production which would represent the maximum profit that any contractor would be allowed to earn on any government contract. At that time the discussion ranged between two and ten per cent. The Secretaries

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of the War, Navy and Treasury Departments, as well as the Chairman of the Maritime Commission, objected to the passage of any Act that would fix an arbitrary percentage of profit on cost of production. They were successful in having the Price Adjustment Boards established, in lieu of an Act fixing a definite ratio of profit, and thought, and I believe rightly so, that many of the contractors who had negotiated with the government for war materiel contracts could not have been expected to fix a price on materiel, which they had to manufacture, and with which they have never had any experience. Many of these contractors took the contracts because they thought it was their patriotic duty to do so, and this attitude was recognized by most government officials. Obviously, no law could be administered successfully which did not give consideration to the individual problems of each contractor.

It has been my privilege to appear before one of the Price Adjustment Boards with one of my firm's clients and his attorney, to renegotiate the prices on contracts obtained by this client. I think, however, it would be well for me to explain, first, the approach of the Army, Navy, and Treasury Departments and the Maritime Commission when contracts are considered subject to renegotiation. The first approach will ordinarily be by sending their representative, who is generally a man of wide experience either in the accounting profession or the Audit Divisions of these departments. This representative will discuss with you the type of information which the Price Adjustment Boards require in order to make a study of the profits earned by your company on government contracts for war materiel. They will generally request balance sheets and profit and loss and surplus statements which give the overall profit and financial data with respect to your company. This is requested for a five-year period.

Supplemental to these financial statements, you will be requested to furnish a breakdown of your sales, cost of sales and profits on all government contracts obtained through these agencies, and sales made to concerns engaged in the production of war materiel. This includes products furnished, as a prime or sub contractor, under lend-lease contracts, and materiel furnished under contract for projects financed by the Defense Plant Corporation which is to be used in plants constructed and equipped for a materiel contractor by the United States Government. They do not require a breakdown of all this by individual contracts or orders, but they want the over-all profit that is being earned thereon. They request also that you show your sales and cost of sales and profits on business not subject to renegotiation. Included in this non-negotiable business should be commercial sales, and sales made directly to agencies or departments of the United States Government, other than those heretofore mentioned, and to foreign governments. Types of commercial business are sales to railroads, sales to agricultural equipment manufacturers and any other sales known to be for commercial consumption. Some contractors are going to have difficulty in determining just what portion of their sales were for commercial consumption, particularly in 1940 and 1941, and possibly in the early part of 1942, before the purchase orders received from customers were required to show what proportion of the products ordered was to be distributed to concerns primarily engaged in war production and what proportion was for commercial use.

To take an example, you may be selling products to a hardware jobber. This jobber in turn may be selling to war industries and a num-

ber of small hardware stores. Obviously, it is difficult to know how much of that product sold to the jobber may have gone directly into the war effort. The thing to do under such circumstances is to write to your major customers and obtain statements as to what proportion of the products shipped to them went to war industries and what part for commercial purposes. Estimates will have to be made in some instances, and the basis for such estimates should be clearly shown in the data submitted.

An analysis of property, plant and equipment is required for the same periods as the financial statements. This schedule will show a segregation as between property, plant and equipment normally used in the business of the contractor and war plant facilities which have been furnished to the contractor, the normal rates of depreciation which it has been the practice of the company to use in determining its financial and its taxable net income, amortization of facilities under certificates of necessity, and rates presently used and amounts deducted for accelerated depreciation due to operating war facilities on a twenty-four-hour-a-day basis, or, in some instances, on a lower basis, depending upon necessity.

In addition to the foregoing, they ask for a segregation of expenses, which are not allowable as a charge against the cost of production as it relates to government contracts. The general guide as to allowable and unallowable costs is the so-called "Green Book" which was recently issued by the War Production Board, and in some instances the contracts will provide that allowable costs shall be limited to those provided in T.D. 5000. I understand that present contracts do not necessarily include the limitations specified in T.D. 5000, but even though these are omitted, the "Green Book" is used as a guide. The government does not intend at present to send in its auditors to do a detail job of obtaining this information, and is requesting contractors to furnish this information for review by the Auditing Division. The Auditing Division has nothing whatever to do with the renegotiations with regard to the allowable profit on contracts. This is entirely within the province of the Board. They review these statements and check the general accuracy thereof for the Board, and submit a report for the Board's consideration.

In addition to the Auditing Division, the Board has a staff of analysts who analyze these statements in detail and make a report to the Board dealing with the economic aspects of the company under consideration. The various Procurement Divisions also review the statements in the light of the contracts that they have negotiated with the contractor, as well as any contracts then under negotiation, either for additional quantities of products already being supplied, or for other products. Now, this is the general picture of the financial data that is to be furnished. While this financial data is being analyzed, in some instances, the Bureau of Internal Revenue examines the tax returns that have been filed by the contractor for the year or years under consideration, and the profits reported on the tax returns are likely to have an important bearing on the question of renegotiating the contract or contracts which are the subject of the review.

The next step will be that the Board will notify the contractor that this data has been reviewed, and set a date for the contractor and his representatives to appear for the purpose of discussing this entire subject with it. Having appeared before the Navy Price Adjustment Board on one of these renegotiations, I think I can fairly say that not only the contractor himself, but his account-

ant and lawyer, are somewhat nervous as to just what kind of treatment they are going to receive and what the Board is going to do to them. You arrive in Washington at the appointed time, and are requested to step into the conference room, where you see about twelve or fifteen men sitting around a table, and your first impression is likely to be one of dismay as to how the three of you can cope with the twelve or fifteen people around the table. It does not add to your confidence. However, after you have been introduced to those present and have taken your seat at the table, you will find that from three to five of the gentlemen are members of the Board, one or two may be from its analytical department, one or two from the auditing divisions, and the others present will be representatives of the Procurement Divisions of these various agencies. These Procurement Division representatives are the men you may have contacted in obtaining your contract, and their presence is essential if the Board is to obtain a complete picture of your operations under government contracts.

The meeting is opened by the Chairman of the Board, and, frankly, he immediately tries to put you at ease, by outlining the approach the Board has made to the question of renegotiating these contracts. He explains that while the Board has a job to do, and it appears that some of the profits made on the contracts under which you were operating indicate to them excessive profits, they did not want to come to a conclusion until they had an opportunity to hear from the management its side of the story. A number of questions had arisen during their review of the financial data which they would like to have explained further, and the reason you were brought down was to receive the viewpoint of the Board and to see if an adjustment of the contract prices could be arrived at which would be fair to the contractor and fair to the government.

They first asked the contractor to give a brief review of the history of his business, the present productive ability of his plant and its employees, what their situation is with respect to deliveries under these contracts, any unusual labor problems which the contractor had faced in the past or was facing at the time, and what the prospects of settlement were. They wanted to know whether the company had established a training division for inexperienced help, the effect of the draft upon experienced employees, and what effect the company felt it had had upon present efficiency and cost, and what effect it might have upon the future operations under these contracts. These questions may be amplified or varied with different types of businesses, or by conditions peculiar to an industry. Points relating to the financial data submitted might be taken up by another member of the committee, probably one representing the accounting or the analytical division.

One may have had a condition in his business where he had been serving one or all of these departments for a number of years with little or no margin of profit, with the result that neither the officers nor the stockholders of that company had heretofore received any substantial salaries or dividends. All such points the Board expects the management to place before it at this conference. There may be differences existing between the Internal Revenue Bureau and the contractor as to the propriety of including certain items of income and expenses when determining taxable net income. You are requested to explain those differences and your position with respect to them. You will be asked to explain your viewpoint with respect to your post war problems, whether you have provided in your contracts with unions or your employees for

severance pay in the event that the war should end suddenly and you receive instructions to stop work on all contracts. In this connection, it may be not only a question of severance pay, but one also of maintaining your accounting and engineering organization in order that you may negotiate settlements with the government up to the date on which the contracts were cancelled or work was stopped thereon.

Obviously, you may be able to lay off labor, but it may be several years before you complete your settlements under these contracts with the government, and get paid for the labor expended and the material which you had on hand, and which were directly applicable to these government contracts. Likewise, you will need the assistance of experienced counsel in connection with these matters.

You will also be asked to explain, in connection with war facilities which you may have erected, in order to perform under these contracts, and which were not owned by the government, as to just what financial problems you would have with these items. You may have one or two questions from the various Procurement officers, though as a general rule they are familiar with your problems and the performance of your company under the contracts.

These are matters which cannot possibly be reflected in your figures. You may try to do so by establishing so-called war reserves, but it is provided in the Act and amendments thereto that the taxable net income reported for income tax purposes shall be given due weight in the renegotiation of contracts. You may be asked to explain a number of unallowable deductions and their purposes. Obviously, these factors should be taken into consideration, because they do affect the final net profit available to the stockholders of the company, regardless of whether or not they may be deducted for income tax purposes.

As an example, it was brought out in our conference with the Board that the Internal Revenue Department had not allowed architects' fees, which were paid by the company on a building that was erected and paid for by one of these agencies. The management explained that under the rules of the department involved, the company had to receive competitive bids from architects before the building could be begun. This would have caused considerable delay in getting the building started. Therefore, the company, in order to avoid this delay, offered to pay these architects' fees out of its own pocket. It was not a very substantial amount, but the company had charged it to expense and the Internal Revenue Department had taken the position that when the war was over, the company might acquire the buildings, and then it would be a capital item. This was allowed as an expense by the Board, and the contractor explained that he was negotiating with the Internal Revenue Department to have the amount allowed as a proper deduction, and the present indication was that the company might be permitted to amortize it over a period of five years. The company did not mind doing it in this manner if the Internal Revenue Bureau so desired, although it was difficult to understand why the item was not allowed as a deduction in the year in which it was spent, because by extending it over a period of five years, the saving in taxes would be substantially higher to the taxpayer. The company had prepared financial data covering a period of twenty-four years of its existence, and it explained to the Board the work it had done over that period for certain of these departments, the average profits over the period, the average salaries of all the officers over the period, and the average of

dividends paid to stockholders. In this case, the average was low. After the Company's representatives had answered the questions addressed to them, they were requested by the Board to retire for fifteen or twenty minutes, while the Board members discussed the situation. That period of fifteen or twenty minutes is a hard one to wait through. You probably will discuss among yourselves, "Well, now, how tough are they going to be? Will the Company have any profits left when they get through with their deliberations?" You can dispel your worst fears, I think, by realizing that you are a producer of necessary war materiel. Every concern that is an important producer of war materiel can recognize that it is to the interest of the country that it be permitted to earn a fair profit and maintain a going business. Also, I think you can accept the fact that the men who have been selected to sit upon these Boards, as well as the accountants, analysts and procurement officers with whom you will deal, are motivated by a deep sense of patriotism, and that they have only one aim, which is to win the war, and win it as quickly as possible.

You are called back into the meeting to hear what you may have expected to be very bad news. In the instance of this experience, we who represented the contracting company were asked what we thought might be a fair adjustment of these profits, which would not be harmful to the company. We answered frankly that we had not formed any definite opinion, that we felt we were to a large extent in the hands of the Board, but that the company desired to meet its viewpoint as nearly as it could, but would ask for the privilege of conferring with the other officers and the Board of Directors of the company, as we were not in a position to commit them at this meeting.

We were informed that it was expected that we would take the Board's suggestions under advisement, and that upon a review of all of the factors of the business, if there appeared to us to be any matters which the Board had overlooked in its deliberations, we could come down and have a further conference, and discuss any new considerations that might have arisen during our review. The Board then laid before us what it believed the Company ought to do. Obviously, we could not tell off-hand what effect this adjustment suggested would have upon the profits of the contractor, but on our way back to our hotel we agreed between ourselves that the proposition sounded fair, and that if it worked out as we visualized it, there appeared to be no reason why the Company might not be able to meet the wishes of the Board.

Briefly, the suggestion was this: The Company had two contracts for the manufacture of certain units. One contract had not been completed and the other was a new contract on which production had not yet been started. A substantial decrease had been made in the prices per unit in the new contract based upon the experience of the contractor. The Company was requested to reduce the price on all units shipped after June 30, 1942, to the price that had been quoted in the new contract, and to refund to the government any amount in excess of the new unit price which had been paid down to the date of the renegotiation.

The Company was asked to waive all right to the operation of the escalator clause down to December 31, 1942. It was further requested, but not as a condition precedent to the settlement suggested, to re-figure its costs upon a new contract received for a unit of another type, to determine if it could not reduce the price of that unit, and to renegotiate such reduction in price with the appropriate procurement officer.

After making a survey, the company decided to accept in principle, the Board's suggestions and an agreement is now being prepared. Further, a review is being made of the costs of the units for which the Board requested that a reduced price be renegotiated, and present indications are that by virtue of the increased volume the overhead rates may be reduced, and that this may enable the company to make some reduction in the originally quoted price of these units.

Now when I observed the methods followed by the government in this instance, and reflected upon the whole experience, it seemed to me that there are a number of advantages in this policy of renegotiation of war contracts which should commend it both to the people of the United States and to the industrial concerns doing business with the government. As long as it is conducted with a spirit of fairness, such as I observed to be the case, it impresses me as being the best method that has yet been devised of handling this perplexing question of government contracts in war time. It reduces to a minimum the element of chance and gamble that is inevitable with contracts awarded hurriedly upon the outbreak of war. In many instances of contracts awarded immediately following Pearl Harbor, manufacturing costs could have been no more than the roughest sort of a guess. The question was to get production moving, and to get it moving quickly. There was no time for the investigation and study that might precede the submitting of bids under normal peace conditions. It was not to be expected that contracts altogether fair to both the government and producers could be arrived at in the circumstances. The policy of renegotiation, based on actual experience in operating under these contracts, is the most logical solution that could have been obtained. It is certainly a superior method, I think most of us will agree, to the cost-plus contract system used during the first World War. We know that this cost-plus system was not conducive to efficiency. It was, on the other hand—as I have already suggested—open to great abuse. Considering the much larger volume of manufacturing and provisioning work required by this war, and the vastly greater outlay of money involved, the adoption of any system that would have tended to make high cost an incentive would have been most imprudent and unfortunate as a public policy. Moreover, I believe it would have been a distinct disadvantage also to private American industry, chiefly because we are writing a business record in this war that is going to be examined very carefully by the public when the war is won. No record of excessive profits under a cost-plus system could be helpful to business when this public appraisal is made, or when our armies return from the field and begin to review the general manner in which they were given cooperation on the home front. What business requires is a record of scrupulously fair dealing with the Government, and that is what I believe is in very large measure being compiled under this system.

There is an added point that the plan of renegotiating contracts as-we-go in this war, provided it continues to be conducted in a full spirit of fairness, will eliminate the occasion for reviewing these contracts, and very likely will eliminate much litigation, when the war is finally over. This will not affect situations brought about by the termination of the contracts, to be sure, but it should apply to all matters prior to the time of renegotiation, or prior to the time of a determination by the government in its current review work that no renegotiation is necessary. In other words, the policy is

one that tends to keep the record clean and clear as we proceed with the war effort. What the government has tended to establish, as I have observed it, is a fair profit system, based on all the factors entering into the operation of an individual business. Business manifestly can expect no more in a period of great national emergency. That it brings government into closer supervision and control over business is no doubt true, but that, like high taxes and many personal sacrifices and inconveniences, is an inevitable consequence of war, in which all citizens must merge their efforts and aims into the common cause. A method of approach less equitable to the government than renegotiation might very likely lead to the necessity for the government to take over and operate entire industries for the period of the war, and while there have been some instances in this war of the seizure and operation of individual enterprises, these have been relatively rare.

To summarize, it is my own conviction that business should not be hostile to this general policy of renegotiation, but rather should accept it wholeheartedly as the best and most flexible method yet developed for controlling the war-time relationship between business and government. I believe that in its present operation it is proving fair. It is tending to hold the national debt to a much lower figure than would be possible under the practices of the last war. It is taking advantage of the experiences obtained during the last war and it is saving business much future castigation and abuse.

I am personally convinced that no company need be unduly apprehensive over the manner of approach to the question of renegotiating contracts. The boards apparently are trying to handle each case in accordance with sound business practices. Any company which has this problem before it should try to have its financial data accurately presented, and should prepare a memorandum, as a guide to management and the Board that has jurisdiction, of specific problems relating to its business, which may not be reflected in the figures, so that these problems can be discussed with the Board. The boards have a job to do, and you should expect them to do it, and in doing so, to protect the interests of the United States Government, which, after all, is you.

Corporate Taxes under the 1942 Law

By J. K. Lasser, C.P.A.

MAURICE AUSTIN'S unblushing assignment to me is that I survey all the changes in the 1942 tax law (other than the relief sections) as they affect corporations. And I might say, pretty honestly, that I cannot do anything more with it in my stay here than to hop, skip, and jump around the directives chronicled by the Congress.

This, far more than any tax bill, in our memory, was a lavish outpouring of solemn, significant innovations concerning our ordinary practice and procedure. There was no new type of tax to write. We'd already had a well defined system of income and excess profits taxes. Yet the wholesale chopping and changing took the now famous 570 pages of law in the Senate. Much of it is clean cut, hard hitting relief from distorted decisions upon prior law. Most of the Congressional reversal of controversial problems are in favor of the taxpayer. Much is decent lucid attention to current needs of business in a war economy. Not enough attention was paid to the needs of accountants struggling to complete their responsibilities before March 15th. But maybe that can get adjusted some other way—if Messrs. Austin and Cooper keep working to get us extensions. Much of it is soothing, consoling lullaby, (in which old rules were changed for the exclusive benefit of taxpayers) and much of it is made retroactive to prior years. A little is yet that type of complicated, unintelligible muttering so well publicized in the newspaper discussions of our old highest bracket sections. Much is yet to be given us by the direction to the Treasury to write the rules in its regulations.

I take it to be a matter of course that the rate schedules in this law are recognized to be ordinary, highly acceptable incidents of a fighting nation prepared to strip itself of all of its worldly goods to win a war. You and I ought not to be concerned with rates—we are interested in the technical phases. In that respect this is a bill to be talked about with zest, and happiness—it is a beautiful new toy to be met by corporations and practitioners with sparkling eyes and joyful faces.

But it is not without its ordeals. First, it suggests we owe it to ourselves and our practice to burn the midnight oil (assuming we can get some of it these days) in constantly studying the law to seek out its opportunities. Second, there is in it the immediate task of filing refund claims for prior years and of revising our old excess profits carryovers to increase or decrease credits for the current year. Thereafter we have the job of making sure we know how to adjust old thinking to the new scheme.

Record of the Changes

If I were to attempt to tell you in detail all the changes that have occurred, I'm afraid that we'd be here most of the night. To avoid that job, I've perspired for a Sunday to build up the attached chart. I hope it describes the more significant alterations in our structure. I have divided the sheets so that, at least, it tells you these things—

The changes in the method of determining income for all taxes.

Presented at the January 11, 1943, meeting on Federal Taxation of the New York State Society of Certified Public Accountants at the Waldorf-Astoria Hotel, New York City.

The changes in the method of determining income for the excess profits tax only.

The changes in the method of computing the excess profits credits.

Other significant alterations in the process to compute the profits taxes.

The new way to assemble and compute the tax.

In addition, I've tried to set down on the charts—

The particular years affected by the changes.

Whether the change requires or permits you to establish a new income or credit in preceding years—and therefore a new carry-over for the income or excess profits tax.

Whether the change suggests a claim for refund for some prior years.

This kind of a chart is really a development of a method most of us use in our own offices, to make certain that we have adequate check lists against which to measure our daily review of each case being studied. With such lists we are in a fair position to make certain, not only that we understand the all-embracing alterations, but that we can fairly muster our own intelligence to meet the task.

Having now complied with the chairman's insistence that you get a record of the corporate amendments, let me now devote the balance of my time to a lot of rambling comments on the effect of the changes upon our own activities and those of our clients.

Need for Check Lists

If you and I attempt to make up tax returns in the face of so sweeping a list of amendments—forgetting all of the complications that preceded them—then I believe that we must fairly accept the responsibility of expertness. That implies a working knowledge of all parts of the law and a degree of willingness to apply ourselves to the enormous trench work necessary to secure our figures. Hesitancy to pour our energies into both, is a most unprofessional performance on the part of many of our brethren. The lack of good faith is best evidenced by the host of errors that lots of us meet when we review the work of others.

For instance, I saw several cases last year where a distressed client ought to have brought serious action against an accountant for the approval of filing under the disclaimer rule. With moderate anguish to the auditor, the client could have used another credit and would have paid a much lower tax. Fortunately, Congress has now intervened to help the drone in its abandonment of the previous disclaimer rule. In effect, it said, "some of you gentlemen seem to have been playing golf on Saturday when you should have been nimble, painstaking and sweating on your job, but we'll overlook that this time." But to assume that Congress will continue to act as the shelter and screen to correct our blunders in the future, is rash—certainly an unalluring gamble. My thesis here is that nothing short of serious perspiration, at our desks, will avoid our troubles.

Example of Need for Check Lists of Income

Consider for a moment the job in assembling the income subject to the tax. That, you know, is a statutory concept—often far different from any other kind of income—one that must be developed by full understanding of the law and the reasoning that led to all of its details. Let's take the income to be determined. If we use the invested capital credit—you know that one rule is that half of some kinds of interest

are to be added back to income. But what is interest for this purpose? Certainly it does not include the following even if they are often called interest.

Interest on open accounts or any other debt not treated as borrowed capital.

Interest paid this year on debts paid off last year.

Interest on factoring agreements or purchase money debts not represented by notes or similar instruments.

Financing or insurance charges often included in interest.

Interest paid on interest obligations (compounded interest) not evidenced by a written obligation.

Amortization of discount on your own bonds when the discount is deductible as an expense under the income tax law.

Discount paid a bank upon customers' or others' notes (they do not create borrowed capital).

And yet all of the foregoing were recorded as having been added back to increase the income for the tax in actual cases checked last year by a couple of offices.

Example of Check List to Construct Earnings and Profits

I'm trying to fashion procedure with you—looking to the way we march against our job. Let's take the assault on the accumulations of earnings and profits to get at the excess profits credit on the invested capital basis. What is the routine? Certainly it ought to include at least the following routine—

1. Most important, a check of the record on the books against the disallowances in the tax returns, or in agents' reports for our entire history. That means far more than review of the shifting of depreciation charges. It can give us: all sorts of disallowed capital costs that really belong in our assets for computing capital increases in basis (following tax free transfers, or in distributions) write offs that can be fairly restored to earnings—and so many other essential notes. And don't miss a complete review of the old 1917 to 1921 returns if your company reached back that far. They are often tremendously valuable.
2. A re-examination of all unusual book entries over the entire corporate and predecessor's history to establish true earnings, even if you do get mixed up in Section 734. I'll talk about that later. Here we've got to look for errors, bad accounting practices, as well as the right to reinstate assets or unamortized costs erroneously charged off. A lot of our book entries which affected surplus as a result of appraisals, recapitalizations, stock dividends, have no effect whatsoever upon earnings. And here, too, we have got to investigate all capital expenditures written off which may be now restored. That may include some or all of the organization costs of a business, (including its fees to the state and attorneys), the cost of raising capital or of reorganizing; the cost of goodwill or the payment for (non-amortizable) contracts which are still used in a business; often the expense of defending or perfecting title to property or of recovering possession of property.
3. A recomputation of all earnings resulting from gain or loss upon sales or exchanges of property so that, following the Act, we have only included the recognized gain or loss (disre-

garding 1913 values) in computing net income in each year.

4. A detailed study of all reserves, so as to get back into our earnings all items that were not deducted in returns when we sought to provide for contingencies, obsolescence, guarantees, pension funds, profit-sharing, sinking funds, depreciation of goodwill, and so many others.
5. A check of our dividend income. There are lots of so-called dividends that do not increase earnings.
6. A review of the need to reduce our invested capital by any earnings and profits of another corporation previously included in it by the Sansome rule.
7. A study of predecessors' records to find if we can increase paid in capital by deficits. That is possible where the reorganization meets the peculiar test of the statute.
8. A study to get the new adjustments following tax free liquidations of subsidiaries and other liquidating transactions —possibly mergers.
9. An examination of all depreciation or depletion charges. Generally we must now recompute upon the cost or substituted basis, even if some other figure was used on books or in returns.
10. And last, all of our entries affecting cash or stock dividends and capital adjustments must be carefully reviewed. An accurate statement of earnings is essential to ascertain whether a deficit really exists. If the effect of correcting entries increases capital and leaves an impairment in earnings, then we do not decrease invested capital for the deficit. That may considerably increase our credit.

Suggested Course of Action

Certainly the experts alongside of me will argue at once that this is not an all-inclusive list of the things that *must* be done to get at earnings and profits. Certainly, too, it omits reference to the skill that our talents and experience can apply to interpret transactions. But possibly it does leave you with the impression that *under this kind of a law,* each of us has a man-sized job to reconstruct our position—that to do it—

1. No matter how unprofessional it may sound, we should assume that we will fumble, botch, and misapply our energies unless we have a complete check list against which we will test every entry made—not against our own judgment, but to an established list of procedures.
2. We must have a willingness to assume that we will flounder and bungle unless we agree that there is no method of producing the lowest tax, except to make every single computation permitted under the law. For example, one of the silly things all of us are finding is that the higher credit will not always produce the lower tax. There are many cases where the lower credit, giving due effect to income adjustments true in the invested capital method or calculations giving full effect to the post war refund, will give a lower net tax. Use of the credit that produces the lowest tax is both mandatory, and most advisable. How can you tell what to use without doing all of the calculations?
3. And when all our work is done we must have the understanding that we will weigh the proposed action against the effect

an election might have upon events in some subsequent year.

Check List in Dealing With Inconsistencies

Another example of our job lies in the sections dealing with inconsistencies. Certainly this year's liberalizing changes leave us with a green signal to go ahead courageously with our computations. There is no man ready to chop off our heads. Note these as part of your check list—

1. Some inconsistencies may be corrected without tax, particularly those that occurred in loss years. In some instances, the penalty and interest may still be far below the credit obtainable in this, prior excess profits tax and succeeding profits years. Careful study of all prior years—particularly those where red figures are reported—is likely to be very helpful in invested capital computations. Certainly you should always measure the advisability of the claim against the possible credit, recognizing the new rule that interest paid is deductible.
2. Corrections may also be useful to those using the income credit, but here we have got to measure changes in base period years to see how they disturb the advantages of the "growth" sections and the new 75% rule.
3. The entire profits tax resulting from a correct calculation under the inconsistencies section need not be paid if the use of the alternative credit will produce a lower tax. If the adjustment for inconsistencies affects only invested capital and results in a higher tax than one under the income credit, the latter is still available. Ours is always the choice—but how can we know the alternatives without the fiery ordeal of a check list and detailed working papers?
4. One of the peculiarities of the law is that the adjustment of prior year tax, plus interest, may exceed the excess profits tax saved by reason of the inconsistent treatment. Congress did not heed a 1942 petition that it limit payments for prior years to the excess profits tax saved by the inconsistent treatment. Congress was also asked to provide that when the tax adjustment for a prior year erroneous treatment had been completed, the transaction should be regarded thereafter as having been correctly treated for income tax purposes; but it refused that relief. As we now rest, this section has nothing to do with erroneous treatment of income in prior years except possibly in the base years—it affects only the credit to determine the excess profits tax exemption. The limitations in the income tax law govern corrections of income. The burden of computing the fruit of our labor for only excess profits taxes is therefore still right on our own doorsteps.

It is obvious that this excise tax on the right to be inconsistent requires serious study of all possible adjustments in years of 90% excess profits taxes. Often it is possible that correction of our mistakes or those of a predecessor in a low income tax year can materially reduce 1940 to 1942 taxes. We now can balance three years results (1940 to 1942) against the penalty, and many of us feel that there will be a lot of other years where the same advantage will be with us.

Check Lists in Studying Consolidations

Still another item for study might be mentioned to suggest the great need for painstaking effort—this involving consolidations. Despite the penalties for consolidating, and despite our great difficulty in making returns without the benefit of clear regulations that we can all understand, it is perfectly obvious that we have no apology for ducking the job of check listing the effect of the rules on our case. And yet many conversations I have heard, suggest that the nightmare will encourage that general tendency this year.

Simultaneously I might mention the scatterbrained willingness to consolidate after weighty calculations prove its advisability—possibly because of losses in one company and profits in another or excessive credits not used by one company. That type of thinking overlooks the need to make a thorough study of the effect of the move upon a great many unusual elements, such as—

1. A subsequent year, since the returns may thereafter have to be consolidated.
2. Claims for special relief that might be obtained by members of the group, were they not consolidated.
3. The difficulty in the intercompany inventory adjustment that must be made after the consolidated period.
4. The cost of taxes due by members of the group that do not have the same fiscal period as the parent—if annualizing is required.
5. The carryovers for future years.

But all of these, as well as all other advantages and disadvantages of consolidation are not private to those of us that have thought about and written about them. They only require your making for yourself a detailed check list of all points to be studied before you get involved in an irrevocable decision.

Check List Upon Reorganizations

Something ought to be said here too about our thinking upon current reorganizations, split-ups, mergers and recapitalizations. We live today in an era in which—

1. We get a great deal of advice to split corporations to get the lower normal tax rates and the $5,000 credit for each company for excess profits taxes.
2. There is a great deal of suggested encouragement for conversion of stocks into bonds in order to get the interest deduction and the presumed advantage in net cost of borrowings.
3. Much is said of the advantage of taking over old companies to secure their net operating loss carryovers, unused excess profits credits, future high credits under the income or invested capital method, possibly sizeable depreciation advantages or even high cost basis for gain or loss to use against our income.
4. A great deal of misinformation is disseminated about de-incorporating companies to get the partnership advantages.

I can't begin here to attempt to reason out all of the pros and cons of such steps. I can leave you with some notes that suggest a number of unusual elements that have got to be studied in all of these before you encourage or discard them.

First, I do not propose to talk of Gregory *v.* Helvering, or Smith *v.* Higgins, or of anything concerned with whether your transaction has decent business motives. That is

peculiarly personal to you. I hope you thoroughly understand the trend that requires that our steps must be germane to the conduct of our business.

But I can suggest that in all of today's activities, current mathematical calculations of immediate savings ought not to neglect elements that are not so obvious to those who do not build check lists. Consider the following—

1. Some of us will look very mournful when the capital gains tax upon liquidations to get at partnerships begins to catch up with our case. And there will be even more anguish when our resulting partnerships are found to be corporations, and partnerships only in phantom and fancy.
2. Recapitalization to get interest deductions—or in the current vein, to get money out of a business via bond redemptions —still must be measured against the wrathful indignation of a law that seeks its tax on dividends paid to stockholders, and also may be quite irritated about your business reasons.
3. Split-ups involve us with the indignities of Section 45. It will take a lot of courage to assume, that we can always find her a devoted, motherly mistress.
4. Remember well the debt retirement credits under the rule that 40% of retirements after September 1, 1942, may be had as a current tax saving. We may lose them in lots of mergers and reorganizations.
5. Our decisions completely eliminate the carryover to new companies—even if we have a tax free transfer. Don't lose sight of your net operating loss deduction, your unused profits tax credit and your carryback as you study any type of transfer between companies.
6. Conversions of stock into borrowed debt can sometimes create capital reductions that will seriously reduce credits. Keep recognizing that as you plan a recapitalization or reorganization to get an interest deduction or to effect other distributions.
7. The cost of effecting reorganizations before a year's end, brings on the dreadful ghost of annualizing income for short periods. It may create excess profits taxes when none previously existed. That may occur in businesses whose earnings fluctuate from month to month; possibly it can come in a great many other cases, particularly since we lose our carryovers in any change in the form of doing business.
8. Some transfers completely eliminate hope of using our relief clauses. As an example of possible difficulties, read the recent Treasury ruling holding that adoption of the section 742 process denies us the right to use 722. Then, whether or not you agree that they mean to apply that under the 1942 law, you must recognize that considerable study is essential to find in all reorganizations and all acquisitions how the relief statutes apply to our own case.
9. Some acquisitions do not permit use of predecessors' or components' income. One startling example is where cash is used to get a predecessor's stock. You've got to follow the exact language of the statute.
10. Some give us only the basis of the assets to the predecessor.

Some permit us to increase the basis by the absorbed company's deficit. That is purely a matter of following the law in your process of acquiring the assets.

11. Some are sure to lose part of the 8% credits on invested capital by getting us into 5%, 6%, or 7% credit brackets.
12. Some lose completely the bargain rates for new capital. Obviously we cannot get the credit in a brand new company following a reorganization.
13. Some break up our hope of proving a growth period for our own company or for a group containing the component.
14. Some transfers may present us with a hidden inconsistency, (for example—errors of a predecessor) and that may cause us a lot of trouble.

And I might go on listing this kind all night. But yet, many of these are manageable difficulties that depend on how we make our transfers. Here, too, the problem is the creation of your own check list of advantages and disadvantages.

One other comment ought to be made on the current trend. We have had a great many drastic changes in our tax laws. I've covered a few, but have had no chance to talk of such important items as these—discharge of debts without income, the use of the new amortization provision, the avoidance of tax on life insurance proceeds, the advantage of using LIFO, the mess caused by the annualizing processes and so many other points described on the charts.

Fundamentally, these changes look like the tax man's paradise—I heard Mr. Randolph Paul call them that a while ago, and so I presume you and I may talk of them openly as being a kind of Congressional grant of a W.P.A. for the relief of our own profession.

Here, then, are our tools for service to our clients. Whether you and I can make the most of the Congressional gallantry and benevolence for tax men—is, I still insist, pretty much a matter of our tenaciously courting the whole welter of a statute and hearings and reports that created the law—then building our check lists out of that study. I hope you have as much fun out of it as I expect to.

The Important Changes In Our 1942 Income and Excess Profits Tax Laws Affecting Corporations

Prepared by J. K. LASSER, C.P.A.

	Section Number	YEARS AFFECTED BY CHANGES					CAN YOU NOW*	
		1942	1941	1940	1939	Prior	Revise Excess Profits Carryover	Claim Refunds for Prior Years
Income for Normal Tax and Surtax								
Capital gains and loss provisions—losses are no longer allowed, but you are given a carryover of non-deductible items for five years; long term profits on sales and conversion of depreciable property and land are treated as capital gains; holding period for long term transactions reduced to six months; land is not a capital asset; tax on long term gains cannot exceed 25%	117	X					No	No
Worthless securities of 95% owned subsidiaries fully deductible	23g	X					No	No
Proceeds from life insurance originally acquired in tax-free transfer are exempt	22b	X	X				Yes	Yes
Bond premiums amortization is sometimes elective and often mandatory	23	X					No	No
Lessees' improvements are not taxed when landlord takes property at end of lease	22b	X					No	No
Taxes and carrying charges on any kind of property (no longer only unimproved property) can be capitalized or deducted, at your option	24a	X					No	No
Contributions to government bodies and those used outside the United States are now included in the 5% allowance	23q	X					No	No
War losses (see law for definition) are ordinary deductions—not capital losses—and new provisions for taxing recoveries	127	X	X				Yes	Yes
Recoveries of bad debts and taxes written off are not income if they did not reduce taxes in prior years	22b	X	X	X	X	X	Yes	Yes
You can use the "last in-first out" method of inventory even if you gave out some statements	22d	X	X	X	X		Yes	Yes

War losses (see law for definition) are ordinary deductions—not capital losses—and new provisions for taxing recoveries	127	X	X				Yes	Yes
Recoveries of bad debts and taxes written off are not income if they did not reduce taxes in prior years	22b	X	X	X	X	X	Yes	Yes
You can use the "last in-first out" method of inventory even if you gave out some statements at variance. See also new relief when there is involuntary liquidation of these inventories	22d	X	X	X	X		Yes	Yes
Bad debts are a deduction in year of worthlessness instead of year ascertained to be worthless and charged off	23l	X	X	X	X		Yes	Yes
Amortization is permitted in case of war facilities acquired after December 31, 1939 rather than after June 10, 1940 and other technical changes	124	X	X	X			Yes	Yes
Creation of exact rules governing deduction of all amounts paid into profit sharing and pension trusts	23l 165	 X					No No	No No
Carryback of net operating loss in 1942 reduces tax of 1941. Thereafter carryback for two years	122l	X	X				Yes	Yes
New optional process to annualize short years for income tax by use of actual income for 12 months starting with short period	47	X					No	No
Revision of method of computing net loss carryover	26c	X					Yes	No
Income For Excess Profits Tax Only								
Exclusion from income of net gains on involuntary conversion and sales of depreciable assets held over 18 months	711		X	X			Yes	Yes
Inclusion in income of all dividends from stocks that are not capital assets for companies using the invested capital method	711a	X	X	X			Yes	No
Amortization of bond premiums (see above), may reduce tax exempt interest added back to income under invested capital method in connection with inadmissibles computation	720	X					No	No
New method of computing income for								
Installment dealers	736	X	X	X			Yes	Yes
Those with long term contracts	736	X	X	X			Yes	Yes
Revision of rules to compute net loss carryover	711a	X	X	X			Yes	Yes
Exclusion of Bonus Income of mines and timber companies	711a	X	X				Yes	Yes
Exclusion for excess output of mines and timber companies	711a	X					No	No

* Some changes are optional, some mandatory. See specific sections.

(Continued on next page)

	Section Number	YEARS AFFECTED BY CHANGES					CAN YOU NOW*	
		1942	1941	1940	1939	Prior	Revise Excess Profits Carryover	Claim Refunds for Prior Years
INVESTED CAPITAL CREDIT								
Elimination of old highest bracket rule in computing excess profits taxes	752	X	X	X			No	Yes
New rules in computing invested capital following the Disposition of property paid in for stock (use basis applicable to year of disposition)	718a	X					No	No
Acquisition of property in reorganization for stock and corporate debt. (The bonds are now borrowed capital but they reduce the basis of stock issued for property)	760	X					Yes	No
Acquisition of property in corporate liquidations	761	X	X	X			Yes	Yes
Some acquisitions of companies permit increase of stock issued for property by deficit of transferor	718a	X	X	X			Yes	Yes
Reduction of percentage allowances on invested capital over ten million	714	X					No	No
BASE PERIOD CREDIT								
Deficit year occurs only if dividend credit, plus tax-free interest, plus deductions, exceed income	713c	X					No	No
Use of 75% average of other three years to get one year in base period	713e	X					No	No
Liberalization of the use of component's income in the base period particularly use of growth formula including component; elimination of need to elect when filing return, right to construct missing periods, etc.	740 742	X	X	X			Yes	Yes
New capital reduction when there is increase in holdings in controlled companies	713g	X					No	No

New capital reduction when there is increase in holdings in controlled companies	713g	X					No	No
New method to reconstruct base period income under the revised relief sections	722	X	X	X			Yes	Yes
Use of new method of computing current income for contractors gives us right to increase base period income	736	X	X	X	X	X	Yes	Yes
General Excess Profits Matters								
New rules liberalizing difficulties with inconsistencies	734	X	X	X			Yes	Yes
Elimination of disclaimer—you can now get the greater credit for excess profits tax	712	X	X	X			Yes	Yes
New optional process to annualize short years—use income for year beginning with short period, etc.	711a	X	X	X			Yes	Yes
Computation of Tax								
Fiscal years ended after June 30, 1942 pay a tax at new rates for period after June 30	108 710	X					No	No
Consolidated returns are permitted for income and excess profits taxes	141	X					No	No
Rate changes bring normal and surtaxes to rates ranging from 25% to 40%	15	X					No	No
New method of computing normal tax and surtax—first deduct (usually) amount subject to excess profits tax	15	X					No	No
Profits tax is fixed at 90% but there is an overall limitation of 80% of surtax net income for the three taxes	710a	X					No	No
Post War refund of 10% of profits tax	780	X					No	No
Debt retirement—40% of debts retired after September 1, 1942 may make all or part of post war refund available now	783	X					No	No
Special rules for computing tax of some mining companies	731	X	X				Yes	Yes

* Some changes are optional, some mandatory. See specific sections.

Some Financial Problems Affecting New York State

By Abbot Low Moffat

IT is a very great privilege to come here, and I particularly enjoyed the opportunity of coming down and meeting some of your directors and the members of the State Tax Commission at dinner where I learned what a delightful profession accountancy is. I learned what a lovely life some of the officers lead and learned also that one of the abilities of a good accountant is to be a good raconteur, in which capacity I think you have most excellent officers.

I am not going to make a speech about the fiscal problems affecting the state of New York, because I could talk from now until doomsday as I think most of you realize. Also, I think it would be well to wait and see what the new governor's idea on some of these subjects will be. There are, however, two or three matters which I thought I would like to mention. One of them is that iniquitous bill which I sponsored, namely the bill affecting quarterly installments of the income tax—changing the fiscal year and treating the poor corporation so brutally.

I think perhaps I ought to go back a short bit. As you know, our income tax in New York State used to be very low: 1%, 2% and 3% in those far-off, happy days; and, while I suppose the people kicked then, I mean the kicking wasn't too important and we had a requirement that half be paid when the tax was due, one-quarter three months later, and the remaining quarter six months later.

Later on we had an emergency income tax which had to be paid in full on the day the income tax was due and, in the meantime, our income tax rates had gone up. So that it was quite a burden on taxpayers to pay this half at one time and a quarter three months and six months later.

You probably know that the fiscal year of the state starts on July 1 and that the state computes its balance on the basis of cash actually received before the close of business on the 30th of June. We are not like cities, which can put a tax on real estate with liens on the properties to collect the taxes. If we estimate we are going to get $75,000,000 from the income tax and our tax department has made a little error and we collect $50,000,000, the remaining $25,000,000 we expected to get is gone and there is nothing we can do about it. So we go on a cash basis for collections.

Now, as I remember it was in 1935, that the problems affecting the state were heavy and, in order to avoid imposing additional taxes, there was recommended by the governor and adopted by the legislature the proposition of advancing certain tax payments which hitherto had been collected in July or November—collecting them before the first of July—so that that cash would come in, thus balancing the budget and avoiding the need of putting on additional taxes. And it was at this time that the second installment of the income tax was advanced from July 15 to June 15 where it not only hurt the taxpayer more by coming two months after the first payment but also coincided with the Federal payment.

Presented at the November 9, 1942, meeting on State Taxation of the New York State Society of Certified Public Accountants at the Waldorf-Astoria Hotel, New York City.

It was also at that time that this first indignity was inflicted on corporations, when we violated all theory of tax law and collected this tax six months before the year for which the tax is imposed. Of course, that is theoretical. Despite all the legal terminology in the New York State franchise tax, it is an income tax, and we only call it a franchise tax to get around the Constitution; but practically it is an income tax and we collected it in May instead of November following the close of the fiscal year as practical common sense. Anyhow, that was the situation.

For some time I was anxious to see if we could help the taxpayers by permitting quarterly installments of the income tax. If you postpone the second quarter—I mean the June 15th quarter—to July 15th, you are taking away from the revenues of the current year the amount of that installment. We are now moving into reverse—we saved taxes by advancing tax dates. If you postpone tax dates, you have to put on that amount of money. But actually what is involved and what I was trying to do was to have real quarterly installments—a quarter in April, July, October and January—which would not only spread the payments but avoid combining the dates with those of the Federal tax. As a practical matter, if we had done it by just postponing those payments until after July 1st, the taxpayers would have had to fork up about $30,000,000 because $30,000,000 which would have been collected before July 1st would not be collected until after July 1st.

A lot of the newspapers couldn't understand that, thought it was a typical opposition to taxpayers and didn't realize that in not pressing the matter we were trying to protect the taxpayers from having to pay an additional $30,000,000. However, if all tax payments fell in the same fiscal year, then you could spread the payments to your heart's content. You could have daily payments, if Mr. Ronan would collect them, and it wouldn't make any difference in the state budget nor the amount of taxes to be collected.

Then came the problem of how to get the fiscal year changed, considering certain very basic facts. This advancing of the tax payments in 1935 resulted in the fact that although by the first of April we had spent a little over three-quarters of our annual expenditures, we had collected a little less than half of our revenues, because the greater part of our collections come in April, May and June. In order to end the fiscal year which would then start about April 1st, so as to precede the first income tax date, in balance you would either have to postpone expenditures or again advance revenues and I tried to accomplish it only by postponing expenditures and wasn't successful. We were able to propose postponement of part of the state aid payments of the state and in compensation to those municipalities which would have some postponement, we were able to advance one of the earlier payments.

We found certain bookkeeping entries in the Controller's office which could be adjusted to actual dates of payment instead of anticipatory debits. Then we found we had to advance first the bank tax (which hurt nobody's feelings except those of some of the bankers, because actually it was putting them somewhat on a parity with other corporations). At that stage we thought everything was set and then, unfortunately, we found an error in one calculation which we had overlooked and that needed one more adjustment, and there was no adjustment available except advancing the corporation tax from May 15th to March 15th, and your own able body was successful in defeating the bill

on that ground—for which I don't blame you.

I personally didn't like the advancing of the corporation tax. I don't think its disadvantages, however, were so great from the point of view of the state as a whole, as its advantage of having the fiscal year changed and the quarterly payments allowed. The governor, however, weighed the advantages and disadvantages, and the bill was vetoed.

Now up to this year we could not make these changes without actually imposing additional taxes because we didn't have a surplus; but this coming year the state will have a surplus and it might be—I have no idea what the governor's ideas may be—worth making these adjustments without advancing the corporation taxes. This could in effect, postpone part of the surplus to a subsequent year, which might be better than reducing taxes, for example, which is contrary to the Federal government's requests to all the states. Whatever will come out of it this coming year I don't know; but I still hope we will get it and I hope we can get it without coming in conflict with you again.

I spoke about changing the fiscal year at the dinner tonight. One of the gentlemen then said, "Why should we, anyway?" Well, regardless of the effect on the quarterly installments of income taxes, I personally feel strongly that it would be to the advantage of the public and the state administration to have the fiscal year of the state start on the first of April instead of the first of July. There is nothing sacred, as you know, about a fiscal year. You choose the fiscal year that is most suitable to the operations of the corporation or, in this case, the operations of the state.

We cannot change the legislative session, which is fixed by constitution; but it would be advisable for the state to bring the expenditures—the commencement of expenditures—as close to the time that the appropriations are made as possible, avoiding or eliminating deficiency appropriations and what we call the "I. A.s", or "immediately available" appropriations, which total millions of dollars a year. It would mean, also, that the expenditure program or the expenditure year would coincide with the revenue year.

At the present our budget is based on estimates of receipts during a fiscal year—which is 12 months—but our expenditures authorized by the legislature run for a period of 15 months.

From the budget point of view the change is advisable for the administrative officials, because, at the present time, they start in August to prepare budget estimates for a year which doesn't begin for 11 months and runs for another 12 months. In short, they are guessing at their needs for a period ending 23 months ahead. The more that period can be shortened, the more accurate their estimates will be and the more experience they will have had behind them.

More important, however, is the effect on budget estimates of revenue. Next month—December, 1942—the governor undertakes to make estimates of revenues for his budget. In revising the estimates made the preceding year and determining what his balance will be on June 30th next—June 30, 1943—when it comes to the income tax and the corporation tax, two of the largest sources of state revenue, all he has to go on is information as to what business conditions have been during the calendar year just ending. When he projects these figures for the subsequent year, he is just wildly guessing at what business conditions will be in the coming calendar year. Also he has only had, of course, about 5 months' collections, and he has to guess as to all his taxes for the remaining 7 months.

If his fiscal year commenced April 1st, then in December when he is revising his estimates as to what his balance will be on March 31st—he will have had 8 months' collections actually in—he will have had all the returns on income tax and corporations before him—and it will be practically a mathematical computation as to what balance he will have. In projecting for the following year, he will already have had the business experience of the calendar year on which to base his estimates.

Then there is another factor, and a very important one. Or, rather, before I mention that, I might say the importance of accurate budget estimates, I think, sometimes is overlooked. I don't know how many of you have been following budget estimates in recent years, but there have been very few times—except the last two or three years—when estimates have been anywhere near correct, and it has not always worked the way you think.

I think it was in 1934—which happened to be an election year—that the estimates were based on a predicted era of prosperity that was to come, on the basis of which the governor recommended (and the legislature went along) eliminating taxes which, had they been left on, would have wiped out the state deficits. Instead of this, we eliminated the taxes and reinstated (which people sometimes forget) the original Roosevelt deficit in all its glory and increased it, and we have been working out of that one ever since. That shows the disaster that can follow from estimates which go completely haywire and are guesswork as to future conditions.

Now a remaining very important reason for changing the fiscal year is one which many people overlook also; that is the effect on temporary borrowing. I don't have the figures directly before me and I can't remember the exact period of years, but it was in either five or six years that the state borrowed temporarily well over $1,000,000,000, and the taxpayers paid, during this period in the early thirties, over $10,000,000 in cash as interest on temporary borrowing. And today we are spending roughly $500,000 a year in interest on temporary borrowing because we operate for 9 months in anticipation of the revenues we are going to collect in the last 3 months. If the fiscal year began on April 1st with the income tax coming in on April 15th—or a large part of it—corporation taxes coming in in May and in June, we would start with the cash coming in at the beginning and we would be in a position to reduce greatly, if not eliminate, the temporary borrowing which has been an important factor, which does not appear as a budget appropriation, to the taxpayers.

Then there is just one other word I want to say, and that is on a matter which, not being an accountant, I shouldn't know anything—and I probably don't; but I kept running into the problem all the time of what was the state surplus or deficit, I think, as a layman, that the view I had (and curiously enough I found most of the officials had it) was what the man in the street had—that when at the end of the year the state announced, we'll say, a $10,000,000 surplus, it meant that it had $10,000,000 clear, free and unencumbered and to the good; and that is not the situation at all.

What is meant by a state surplus at the present time is the cash which happens to be in the bank to the credit of the state at 5:30 p. m. on June 30th. No attention is paid to the bills which are in the drawer and chargeable against that cash. I had a number of conferences with the Controller's office in trying to work out a statement of what the balance of the state budget really was. We

ran into a number of serious problems such as the fact that we have all these immediately available appropriations, and for a long while there seemed no way of working out a fair balance. I finally adopted this policy and you, as members of your august profession, can probably tell me if I am right. I have been going on releasing them for the last two years and haven't had any criticism and I still think I am sound; but would like to get further checks.

Let me give you an example: If we appropriate $5,000,000 to build a state office building and we impose $5,000,000 of taxes to pay for that office building and we collect the $5,000,000 during this year, I assume that that budget is in balance even though actually because of construction delay we spent only $1,000,000 and have $4,000,000 in the bank at the end of the year. Under the present theory we would have a $4,000,000 surplus. If when finally the building has been completed, it has cost only $4,500,000 we lapse $500,000 of the appropriation. Then, at that time, we end up with a budget surplus of $500,000 having collected $500,000 more than the actual liability set against it.

Now let's assume that in one year we had the $5,000,000 of appropriations and also of revenues. The next year we appropriate $3,000,000 for a hospital and put on $3,000,000 of taxes. Meanwhile we get to work a little sooner than anticipated. We have this $4,000,000 of cash on hand, so we spend some of that money in anticipation of the revenues to be received next year. To me again that makes no difference in the budget surplus. It may reduce your cash, but the $5,000,000 was in balance—the $3,000,000 was in balance —assuming each time you collect the full amounts. It is that theory I am trying to put into effect in announcing the actual budget surplus of the state—namely, the amount of cash actually collected by the state up to the close of a fiscal year—the amount of appropriations made against it, and the difference after crediting any borrowings against future revenues is a surplus or a deficit regardless of whether the cash has physically been spent.

On that basis this year instead of $53,000,000 as announced, we had a $46,000,000 surplus. In other words, $46,000,000 free and absolutely clear. Up to now this difference hasn't been important. The budget has been balanced by estimating that the amount we borrow from future revenues and pay out on next year's appropriations ahead of time equals the lag of expenditures under past appropriations. In other words, at the end of a fiscal year normally there will be perhaps $20,000,000 of appropriations still outstanding for expenses which physically don't get paid for two or three months. Equally, we pay $20,000,000 of next year's appropriations before the beginning of the fiscal year.

We have been going on that theory for a number of years and actually it has worked out pretty closely, so it did not make too much difference but today a spread is beginning. This year it is $7,000,000; next year it may very well be a larger sum. And if the fiscal year is changed to April 1st so that we no longer have these immediately available appropriations made before the beginning of the fiscal year, you will not have the compensating borrowing from future appropriations. We would normally end up a fiscal year then with perhaps $20,000,000 of cash, with $20,000,000 of obligations outstanding to be paid from that cash and probably paid within three months. Under the present theory it would be announced as a $20,000,000 surplus; actually you would be absolutely in a budget balance with

no surplus. But if this $20,000,000 cash is announced as a surplus, there may be an effort to reduce taxes; and each time you cut taxes on the basis of a cash instead of actual surplus you are going to get deeper and deeper into the hole. That is one of the things I am hoping the new governor will undertake to do—put the state on a straight budget basis instead of, well, I call it a "phoney" cash basis.

The Revoke

By GEORGE O. MAY, C.P.A.

RECENTLY, a group of accountants were playing bridge, A and B who were commission accountants being partners against X and Y, who were company accountants. In the course of a hand in which diamonds were trumps, and A was declarer, X, at his right, led the three of spades; A played a diamond; Y played the four of spades, and the five of spades was played from the dummy. Just as the declarer drew and played the five, B said, "No spades, partner?" A looked at his hand and with an apology drew back the diamond, substituted the two of spades and proceeded to turn the trick. Y protested that he should be allowed to change his card, and an animated discussion ensued. No book of rules was at hand, but A insisted that the rule was clearly derivable by analogy from the Federal Power Commission rules of accounting with which they were all familiar. He was merely correcting an error which under the rules could always be done, whereas Y was attempting to change a treatment which had been adopted "upon a consideration of the entire setting at the time of the transaction," (quoting a Commission brief). He contended that the change of treatment was not permissible. He pointed out that if Y had really desired to protect himself he should have anticipated the possibility that A would change his play and have laid down a little higher card (say the six) that would have won the trick in that event.

Y admitted the analogy but maintained that the rules of the Commission were wrong and said that he would refuse to accept them even to settle a bridge dispute unless they were sustained by the Supreme Court. The bridge game was abandoned and Y began an argument on the issue thus raised.

Y said "I used to be a railroad accountant, and I remember that in 1878 the Supreme Court was called upon to determine the net earnings of a number of railroads. In doing so, it held that a provision for depreciation could not properly be included among the items deductible from gross revenues in order to determine the income of a railroad, saying that only actual expenditures could with any propriety be deducted. At the same time the Court upheld a charge against revenue of certain actual expenditures for improvements." (Incidentally the Court was there concerned, as the Federal Power Commission is, with the earnings of the enterprise—not the earnings of the company conducting the enterprise. For instance, it disallowed interest as a deduction on the ground that that was a payment out of earnings of the *enterprise* though it might be an expense to the *corporation*.) Y added that in accordance with that decision hundreds of millions of dollars had been expended for improvements since 1878 by the railroads of the country and charged to operating expenses or income and that this was done as a better means of maintaining the integrity of the property account than a charge for depreciation.

Y went on: "There are two theories about railroad maintenance. Under one theory, which was followed during the great period of railroad development, and is still followed abroad, no entry in capital accounts is made when property is replaced, but the cost of replacement is charged to operations. Under the other, charges for amortization of cost—wrongly called depreciation—

are made to operating, and when the property is replaced the cost of the unit retired is written out of the property account and the cost of the replacing unit is written into that account."

A said "We are not talking about railroads" but Y went on—"I know but according to your idea, the Supreme Court was wrong in 1878 and the second method is better; maybe so, maybe not. And as you apply your reclassification in practice, you would say that the cost of the formerly existing unit is wrongly in the property account and must be taken out because that particular unit is no longer in existence. At the same time, you would say the charging of the replacing unit to operating was 'a transaction accounted for by consideration of the entire setting at the time of the transaction and has been accounted for under accepted accounting principles; it should not be changed at a later date.' (I am quoting once more from a statement of the principle laid down by a commission accountant as cited in a commission brief, and it has been applied in circumstances such as I have assumed.) Is that fair or good accounting?

"Again, a mining company may charge no depletion; but in view of the fact that it is not charging depletion may write off all development costs. Would it be just for a commission to require it to provide for past depletion by a charge to surplus without permitting it to restore to surplus any part of the development charges written off if it so desired?"

"I insist," he said "that there can be no justice in partial restatement of accounts as between two parties at the instance of one party. Accounting procedures are designed as a whole; they must be considered as a whole and they must be adjusted as a whole. A company may adopt the less conservative alternative in one respect and the more conservative in another; indeed, this is often preferable to going to extremes in either direction. If a company wants to change a part of its accounting procedures, no auditor would approve its doing so without considering the merits of the change in relation to the system as a whole."

A said, "But if the items that have been charged off are now capitalized, the result will be a duplicate collection from consumers." Y replied "Again I say, maybe so, maybe not. Since the Commission is seeking to change the old accounting procedures, the burden should be on it to prove that such a result will follow in a particular case. But the strong probability is that the change of accounting to an original cost basis as a whole will benefit consumers anyhow. In some cases and in one respect the benefit may be partially offset if you concede my point but that is no argument for treating that one aspect as a matter entirely divorced from the rest of the problem and assuming, contrary to all probability, that in every case there will be a double charge.

"I don't deny that there may be cases where what the lawyers call 'estoppel' might fairly be regarded as standing in the way of changing a past allocation, but the Commission's sweeping universal rule is unreasonable and unjust."

At this point, someone suggested that they had better settle the bridge question and go home. A third party, who was not an accountant but a bridge authority, was appealed to; he said that Y was right, and that if A was permitted to change his play, Y must also be permitted to change his. That, he said was the rule of the game and also plain common sense and common fairness.

In an address which was printed in the issue of this journal of May, 1941, I suggested that accountants should be willing to reexamine the theory of corporate cost, which has

been one of the first principles of accounting, and examine the original cost theory sympathetically. I drew attention to arguments which could fairly be advanced in support of the idea of enterprise accounting in the field of public utilities. I still hold to the opinion I then expressed, but I am unable to accept the development of Federal Power Commission accounting as illustrated by the foregoing parable.

The distinction which it makes between (a) reclassification of expenditures, (b) reaccounting for expenditures and (c) correction of errors in accounting for expenditures (two being permissible and the third not) strikes me as artificial and not defensible on any accounting grounds. It operates unjustly and it also defeats the Commission's objective of uniformity as does the adoption of rules that disposition "shall be such as the Commission may direct." Moreover the Commission takes the position that it is adhering to accepted accounting principles when it departs from accepted accounting principles as defined by its own accountants upon grounds of policy. In doing so it seems to me to be resorting to the accounting according to expediency for which it has severely condemned managements of the past.

In my address of May, 1941, I expressed regret that while other commissions were imposing original cost accounting the I. C. C. seemed disposed to disregard original cost in the case of the reorganized railroads where it would operate to the advantage of the roads. I should therefore point out that shortly thereafter the full Commission reversing one of its divisions, held that the full property investment should be recorded on the books of the companies resulting from reorganization, and in the Revenue Act of 1942, provision was made for preservation unchanged by reorganization of the "basis" of railroad property for the purpose of determining invested capital and also for the ascertainment of income. This fair and broadminded attitude is in the ultimate public interest and may be commended to those who, inspired perhaps by a feeling of indignation at past abuses in the utility field, think that justice to utilities should be retributive and that reasonableness is to be found at the opposite pole to that of past unreasonableness.

Decision of New York State Board of Certified Public Accountant Examiners

In the Matter of the Proposal by

The American Federation of Government Employees, Lodge No. 15
The State Tax Examiners Association,

and

The Society of Municipal Accountants

For Approval of a Rule as follows:

> "Persons employed by the U. S. Government or by the State of New York or any of its political subdivisions as accountants or auditors who have been actually engaged in doing work as accountants or auditors for at least two years, shall be considered as having experience equivalent to the required two years' certified public accounting professional experience."

Preliminary

The three organizations had requested a hearing before the Board of Examiners on the matter of the recognition of government accounting experience as the equivalent of the required two years' Certified Public Accountant Experience.

They were advised to submit their proposal and arguments in writing.

On December 9, 1941, they filed with the Board their joint proposal as above, and each filed a brief thereon, one with five exhibits in support of its position.

Since the adoption of the proposed rule would affect the entire profession in the State of New York, the Board invited the New York State Society of Certified Public Accountants to consider the proposal and if it wished to do so, to submit a brief giving its views thereon.

Under date of May 15, 1942, the New York State Society of Certified Public Accountants filed, with the approval of its Board of Directors, a report of its special committee opposing any such general rule for "two fundamental reasons":

(a) That it would violate the evident intent of the Commissioner that there should be only one experience criterion, and

(b) That it would unfavorably affect the public interest by circumscribing the discretion now vested in the State Board to determine the adequacy of an applicant's experience.

Copies of this report were furnished to the three petitioning organizations.

Under date of June 23, 1942, The Society of Municipal Accountants and The State Tax Examiners' Association submitted a modification of the proposed rule which incorporated in the rule a provision that the work of government employees as accountants or auditors should be "of a grade and character satisfactory to the Board of Examiners."

Under date of June 29, 1942, The American Federation of Government Employees, Lodge No. 15 submitted a three page letter in answer to the report filed by the New York State Society of Certified Public Accountants which did not refer specifically to the modification of the proposed rule as submitted by the other petitioners. However, at the hearing upon the petition, representatives of the Federation stated that it was in full accord with the other two petitioners as to the necessity of modifying the proposed rule by the inclusion therein of the words "of a grade and character satisfactory to the Board of Examiners."

Hearing

The Board of Examiners notified the petitioners and others interested that it would hold a hearing on the matter of the proposed rule at 10:30 A.M. on Tuesday, June 30, 1942, in Room 817, State Office Building, 80 Centre Street, New York City.

At the hearing there were present all members of the Board of Examiners, representatives of each of the petitioners, of the New York State Society of Certified Public Accountants and of the State Education Department. A representative of the American Institute of Accountants was also present as an observer.

At the start of the hearing, it appeared that all parties recognized the inherent dangers of a general rule and conceded that any recognition of other experience as equivalent to any part of the required two years of C.P.A. experience must be left to the discretion of the Board. It was also generally recognized and admitted by all parties at the hearing that under the present rules the Board had full power to consider individual cases upon their merits and to grant such measure of recognition to experience gained in government or private employ as might in its opinion be in keeping with its duty to give reasonable protection to the public in the issuance of C.P.A. certificates.

In the course of the hearing, it was admitted by the petitioning societies that the certificate of certified public accountant is not an educational degree but a license to practice and that such license is to practice not merely accounting but certified public accounting. This distinction is important. It is not merely knowledge of accounting that is involved but primarily the judgment gained by experience in the field. Knowledge may be obtained through study or experience in other fields but judgment in the application of accounting principles is at least equally as important for the protection of the public.

The public interest in the maintenance of public accounting standards is constantly increasing. In May, 1942, the American Institute of Accountants addressed an inquiry to governmental and other organizations representing credit grantors and investors with respect to possible new legislation in some other states. It is evident from the replies that all of these bodies are deeply concerned with the maintenance of standards, including the experience requirements. The New York Stock Exchange, after referring to its requirement of audited reports, stated:

> "If this agreement is to provide protection for security holders, the accountants who certify to the accounts must be properly qualified; otherwise the certificates would have little or no meaning. * * * We would consider any lowering of the standards required for the possession of such a certificate as being against the public interest."

The chief accountant of the Securities and Exchange Commission stated:

> "This requirement for certification is intended to ensure review of the financial representations by a well qualified and independent accountant. The worth and contribution of such a review obviously depends on the experience and expertness of the independent accountants who participate in the review. Consequently, any trend toward lowering the qualifications required of such accountants would result in the deterioration of these statements and, in my opinion, should be resisted strenuously."

The National Association of Credit Men said:

> "This organization would register opposition to any movement

which might lower the standard of requirements for the accountant's certificate. We believe the present requirements are fair."

The Robert Morris Associates, a national association of financial credit men, in its bulletin for June, 1942, stated on Page 26:

"Bank credit officers rely to a considerable extent on financial statements certified by independent public accountants. The C. P. A. certificate rightly carries a good deal of weight in any formation of the banker's judgment as to how far he may rely on financial statements certified by outside accountants. It is, therefore, a matter of great interest to bankers to have a high standard maintained for the issuance of C. P. A. certificates. * * * While the education and experience requirements vary among the states, the great majority of them do require some practical experience, and the effort of the Robert Morris Associates should be to raise the requirements where they are not already high enough and to prevent anyone from lowering them."

The Treasury Department Committee on Practice stated in the reply by its chairman:

"The maintenance of the present high professional standards for the issuance of the certified public accountant's certificate would constitute the principal factor justifying the continued recognition of certified public accountants without further examination."

Opinion

Independent public practice of accountancy differs from governmental auditing and private accounting. It is directed to all of the accounts as distinguished from specific matters. It requires consideration of the varied and sometimes conflicting interests of creditors, stockholders, management and government. Complete independence from all of these interests is essential to an unbiased opinion. The government employee is concerned only with the government's interest, while the private accountant is inescapably a part of management. Neither develops the independent viewpoint of the public practitioner which more than any other one thing, distinguishes the professional man from other accountants.

The government or corporation employee may have superior knowledge in his particular field. The revenue agent has greater familiarity with tax regulations and rulings. The corporation accountant is more intimately acquainted with the details of the business. The lawyer knows more law and the appraiser knows more about values. They all may have numerous contacts with diversified businesses and accounts, yet one would hardly say that this by itself makes them qualified public accountants. Each of them is a specialist in his own field, doing necessary and useful work, but it is not public accounting, even though it may require the keeping of accounts or a more intensive examination of particular accounts.

The first C. P. A. Law was enacted in New York State in 1896 and, from the beginning, practical experience in public accounting has been required for a certificate. In the early days, this question arose principally under the provisions of the waiver clause in the first law. The minutes of the Board of Examiners show that under date of May 6, 1897, the Board disapproved the application of Mr. Edward C. Cockey as he did not appear to have been in practice as a public accountant during the time required. Mr. Cockey was the first president of the Institute of Accounts, one of the two organizations which had worked for the passage of the first

C. P. A. Law. He had been in accounting work for over forty years and stood very high as an accountant in New York. Nevertheless, his application was not approved and the minutes of a Board meeting held on June 23, 1897, record the following:

> "The case of Mr. Edward C. Cockey, No. 125, has upon receipt of copies of correspondence with the Regents' office been carefully reconsidered by the full Board. Whatever may be the qualifications of the applicant and no matter how high his reputation, the law and the rules of the Regents, which the Examiners have no power to change, require in addition to professional qualifications proof of actual practice. The applicant makes no mention in his application of any work done by him as a public accountant but covers the time from January 1, 1890 as 'Superintendent of Supplies and Storekeeper of the Western Union Telegraph Co. and agent of the Estate of Jay Gould.' If, besides these positions, he has also engaged in practice as a public accountant, that fact should appear by an amendment to his application."

Other similar cases might be cited from the Board minutes during these earlier years and throughout the following years. There has been no change or break in this general policy. The present rule providing for recognition of equivalent experience in the discretion of the Board of Examiners was adopted purely to provide relief in cases of undue hardship under an arbitrary rule. It was never intended to effect a change in the established requirement of actual experience in public accounting and was approved upon the tacit understanding that the discretion vested in the Board would not be abused.

Admittedly, government has entered more and more into the business field and has found it necessary to employ more and better trained accountants. New laws have been enacted imposing taxes which are based upon accounting records and more and more businesses have been subjected to government supervision of their financing and operations. Beyond question, this has tended to raise the standard of accounting knowledge required by government employees but it is still true that their responsibility is directly to the governing body, while the responsibility of the public accountant is to the general public represented not only by government but also by individual interest as creditors, stockholders and managers. Even if this were not true, it is still a fact that every certified public accountant in the State of New York has been required to obtain actual experience in professional public accounting, and everyone studying accounting with any serious thought of entering public practice must have had knowledge of this requirement. If they have chosen to enter other and more lucrative fields in which a license is not needed, they have simply failed to meet one of the established requirements for a license.

The object of the professional license and the only justification for it is the protection of the public. The professional reputation of the practitioner is his greatest asset. He cannot afford to jeopardize it. This fact alone, selfish though it may be, affords a measure of protection to the public relying upon his opinion in accounting matters. The government employee is under no such obligation. His livelihood is assured by his job and pension rights and is in no way affected by his reputation as a public accountant, whether or not he has a license to practice as a certified public accountant. It would seem that in addition to accounting knowledge the professional man should be required to assume the

professional responsibility and to have at least some contacts with the professional viewpoint before being granted a license to practice.

It might be well to note in this connection that the Association of Certified Public Accountant Examiners, which is an association of the state boards of all of the states and territories in this country, at its annual meeting held in Detroit, Michigan in September, 1941, unanimously approved the following recommendation:

> "Private, as distinguished from public, accounting experience should *not* be accepted for more than one-third of the experience requirement and only upon a reduced basis. Only in public accounting may the necessary breadth of experience combined with the proper respect for the public responsibilities involved be obtained."

Decision

The present policy of the Board is to accept high grade experience in government or private employ as equivalent to a minor portion of the required two years' C. P. A. experience. It does not insist that each candidate must have a full twenty-four months of experience under the supervision of a certified public accountant in public practice but does hold that a reasonable amount of such experience is necessary to the public interest. In the opinion of the Board, it has not been shown in the briefs submitted or in the statements made at the hearing that the work performed by the members of the three petitioning associations is professional accounting of the same scope and purpose as the work of the professional public accountant, even though some of them possess as much or greater accounting knowledge. The Board, therefore, disapproves the proposal submitted by the three petitioning associations and holds that its previously established policy be continued.

Norman E. Webster
George E. Bennett
Edwin E. Leffler
Winfield McKeon
Walter N. Dean

November 13, 1942

RECENT PUBLICATIONS

CONSOLIDATED STATEMENTS
By Edwin J. B. Lewis
Ronald Press, New York, 1942
103 pages, $6.00

This text is a self-contained analysis not only of the principles and methods of consolidation, but also of the construction of adequate working papers and of the interrelationships involved in corporate accounts. It is intended for use both by students in advanced university courses who are preparing for a career in accounting and by accountants in corporate and professional practice who desire to reexamine logically the theory underlying consolidated financial statements. The analysis consists of fifteen lectures. The first ten lectures outline the principles of consolidation and illustrate their application to concrete situations. Later lectures deal with foreign subsidiaries, multi-company consolidations, short-cut methods for solving problems within the time allowance of professional examinations, and illustrative case material from the annual reports of representative American corporations. The lectures are arranged to permit considerable flexibility in the use of each according to the needs of the individual class and the amount of time available. The text also includes problem and question material which is graded as to difficulty in order to permit a constant check on student progress. The author is instructor of accounting at Northwestern University.

LECTURE NOTES ON THE LAW OF ACCOUNTING
By James L. Dohr
King's Crown Press, New York, 1942
136 pages, $2.25, mimeographed

These lecture outlines on the law of accounting, supplemented by voluminous notes containing legal and accounting citations, have been prepared primarily for use in the classroom, but they should be equally useful to accountants and lawyers in their practice. After three introductory and general lectures, the balance-sheet is taken up and a lecture devoted to each of the categories commonly found therein. The law of income statement is then dealt with, including a lecture on corporate distributions. Final lectures are devoted to the law of public accounting practice and the proof of accounting facts. The legal and accounting citations which accompany each group of lecture notes will be found practical and convenient for the use of students, lawyers, accountants, and others who are concerned with financial matters. The author is Director of Research of the American Institute of Accountants, and is Associate Professor of Accounting, at the School of Business, Columbia University.

ELECTIONS

The following is a list of applicants admitted to membership, and associate membership in the Society and also associate members advanced to membership at the meeting of the Board of Directors held on December 10, 1942:

Membership

Anderson, A. John,
With U. S. Army.
Berkowitz, Philip, 11 West 42nd Street,
Cohen, Isadore J., 1528 Walnut Street, Philadelphia, Pa.
With Laventhol & Krekstein.
Egbert, Herbert Seaton, 90 Broad Street,
With Lybrand, Ross Bros. & Montgomery.
Enfeld, Louis, 570 Seventh Avenue.
Goodman, Max, 175 Fifth Avenue.
Graven, Frank B., 295 Madison Avenue,
Of Crowley & Company.
Irving, Robert Charles, 80 Maiden Lane,
With Touche, Niven & Co.
Gross, Louis, 10 East 43rd Street,
Of Arthur J. Seed & Co.
Jaffe, George, 21 West Street,
With Supervisory Cost Inspector, U.S.N.
Kirkebye, Henry T., 120 Broadway,
Of Barrow, Wade, Guthrie & Co.
Kruglov, Louis Allan, 512 Fifth Avenue.
Mather, C. Ronald, 141 Broadway,
Of Stagg, Mather & Hough.
Miller, Robert, 21 West Street,
With Office of Supervisory Cost Inspector, U.S.N.
Orlans, Abraham S., 570 Seventh Avenue.
Pollack, Samuel B., 55 West 42nd Street,
Of William Rubin & Co.
Ratner, David, 10 East 43rd Street,
Of Arthur J. Seed & Co.
Rosenblatt, Martin, 415 Lexington Avenue.
Siegel, Nathan, 270 Broadway.
Simon, Samuel, 286 Broadway, Monticello, N. Y.
Solomon, Julius, 299 Broadway.
Stone, Lester E., 1116 Liberty Bank Bldg., Buffalo, N. Y.
Of Harry Lewis Stone & Co.
Volk, Irving J., 280 Broadway.

Associate Membership

Ackerman, Charles A., 40 Wall Street,
With Westinghouse Electric International Company.
Alster, Hyman S., 45 Broadway,
With Federal Communications Commission.
Anderson, Stanley Ellsworth, 111 Broadway,
With National Lead Company.
Axel, Samuel, 1220 Broadway,
With Axel & Axel.
Barber, Raymond Jenness, Jr., Potsdam, N. Y.,
With Clarkson College of Technology.
Brussel, W. Harrison, 125 Park Avenue,
With S. D. Leidesdorf & Co.
Christian, James A., Jr., 18 East 48th Street,
With Harris, Kerr, Forster & Company.
Devlin, John William, 22 East 40th Street,
With Johns-Manville Corporation.
Doyle, William Francis, Jr.,
With U. S. Navy.
Druce, Murray, 280 Madison Avenue,
With George S. Bickwit & Company.
Duplessis, Edward K., 67 Wall Street,
With Arthur Andersen & Co.
Housman, Nathan, 220 Fifth Avenue,
With H. Merdinger & Co.
Dykeman, Francis Charles, 56 Pine Street,
With Price, Waterhouse & Co.
Fernandez, Frank,
With U. S. Army.
Finn, George J., 20 Exchange Place,
With Robert Winthrop & Co.
Fleischer, Mark I., 1775 Broadway,
Of Mark I. Fleischer & Co.
Frankel, Isaac, 514 Congress Bldg., Miami, Fla.
With War Department, Office of Division Engineer, North Atlantic Division.
Froese, Ralph Walter, 101 Park Avenue,
With Owen Petersen & Co.
Glass, Louis, 521 Fifth Avenue.
Haas, Malcolm G., 90 Broad Street,
With Lybrand, Ross Bros. & Montgomery.
Higgins, John Thomas, 22 East 40th Street,
With Haskins & Sells.
Hilbert, John Augustine, 90 Broad Street,
With Lybrand, Ross Bros. & Montgomery.
Hilperts, Emil A., Jr.,
With U. S. Navy.
Kopp, Martin H., 125 Park Avenue,
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Leach, Michael Edward, 61 Broadway,
With General Gas & Electric Corporation.
Lehmann, Arthur, 30 Pine Street.

Neubauer, Walter, 1220 Broadway,
With Axel & Axel.
Purala, Martin, 90 Broad Street,
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Rabinowitz, Eli,
With U. S. Army.
Ratner, David,
With U. S. Army.
Ryan, John M., Paducah, Ky.,
With Rust Engineering Co.
Schlumpf, Howard James,
With U. S. Navy.
Sagor, Irving,
With U. S. Army.
Shanahan, Edward Patrick,
With U. S. Army.
Wexler, Louis,
With U. S. Army.
Wiendieck, Elwood, 253 Broadway,
With U. S. Treasury Department, Foreign Funds Control.

Advancement from Associate Membership to Membership

Aron, Sidney G., 342 Madison Avenue,
With N. Y. State Dept. of Unemployment Insurance.
Elfers, Henry C.,
With U. S. Navy.
Emanuel, Meyer M., Jr.,
With U. S. Army.
Guest, Stanley Francis, 67 Wall Street,
With Arthur Andersen & Co.
Sirkin, Sidney,
With U. S. Army.

The number of members in the Society as of January 1, 1943, is as follows:

Members	3,701
Associate Members..	467
Total	4,168

Authors of Articles In This Issue

J. K. LASSER, C.P.A., author of **"Corporate Taxes Under the 1942 Law"** received his education at Pennsylvania State College, graduating in 1920 with an engineering degree. He has been a member of the Society since 1934, of the American Institute of Accountants since 1926, and also holds membership in the National Association of Cost Accountants. Mr. Lasser is also a Certified Public Accountant of New Jersey and California, and is now serving on the Society's Committee on Federal Taxation. He is author of the current tax books "Your Income Tax" and "Your Corporation Tax."

J. ARTHUR MARVIN, C.P.A., author of **"Renegotiation of Contracts—An Experience"** is now serving as President of the New York State Society of Certified Public Accountants and is a partner of F. W. Lafrentz & Co., New York. He has been a member of the New York State Society since 1928, and also holds membership in the Virginia and Illinois State Societies. For several years Mr. Marvin was Chairman of the Committee on Public Relations of the New York State Society, and has served on the similar committee of the American Institute of Accountants. He is also a member of the National Association of Cost Accountants, of which he is now serving as a director of the New York Chapter. Mr. Marvin is at present acting in the capacity of a supervising auditor in the Third Naval District with the U. S. Navy.

GEORGE O. MAY, C.P.A., author of **"The Revoke"** is a retired partner of Price, Waterhouse & Co. and now serves as consultant to that firm. He has been a member of the Society since 1931 and the American Institute of Accountants since 1902. For several years Mr. May was active head of the American Institute's Committee on Accounting Procedure and of earlier committees of similar scope. He has also served as Chairman and member of various other committees of the American Institute. He is past president and past director of the National Bureau of Economic Research, Inc., past vice president of the American Economic Association, past director of the American Statistical Association, and is now a director of the Council on Foreign Relations, Inc. Mr. May is the author of many articles and is at present lecturer on the faculty of the Graduate School of Business Administration, Harvard University.

ABBOT LOW MOFFAT, author of **"Some Financial Problems Affecting New York State"** is Chairman of the Ways and Means Committee of the New York State Assembly. He was educated at Groton School and Harvard. Completing his work at Harvard in three years, he went to the Far East where he spent a year. He then returned to New York and entered Columbia Law School, graduating in June, 1926. In 1927 he was appointed an Assistant United States Attorney, which position he held until July, 1928, when he resigned in order to run for the Assembly. Mr. Moffat has been in the Assembly for fifteen years, and at present is serving as Vice Chairman of the Post-War Planning Commission, and as a member of the State War Council.

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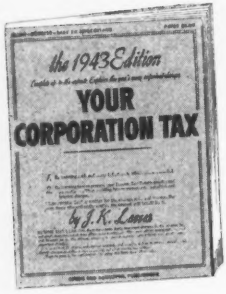

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